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Replacing the Estate Tax with a Reimagined Accessions Tax

JOSEPH M. DODGE*

INTRODUCTION

The federal estate, gift, and generation-skipping taxes (“estate tax system”) are excise taxes on the cumulative lifetime and death-time gratuitous transfers of an individual, with the tax being imposed on the transferor or her estate. These taxes (except for the gift tax) are set to expire in 2010, only to be revived in 2011 with a much lower exemption (and higher rates) than the 2009 version of these taxes.¹ A splendid window of opportunity currently exists for Congress to consider replacing the estate tax system with an alternative. There are five plausible alternatives that fall into three categories: (1) patching the gap in the income tax that results in permanent exclusion of unrealized gains at death (“repealing stepped-up basis”);² (2) treating gratuitous receipts as gross income under the income tax (“the inclusion-in-income

* Stearns Weaver Miller Weissler Alhadeff & Sitterson Professor of Law, Florida State University College of Law. Harvard University, B.A., 1963, L.L.B., 1967; New York University School of Law, L.L.M. (in taxation), 1973. The stimulus for this piece was the hearing held in the Senate Finance Committee on March 12, 2008, to consider alternatives to the present federal wealth transfer taxes. The three invited witnesses (Professors Lily Batchelder, David Duff, and myself) all favored a transferee-oriented wealth transfer tax over the existing transferor-oriented system. The written testimony is available online. See United States Senate Committee on Finance, Hearings, <http://finance.senate.gov/sitepages/hearing031208.htm> (last visited May 17, 2009). I wish to thank David Duff, Jim Repetti, Adam Hirsch, and attendees of the Critical Tax Conference held at Florida State University College of Law on April 4th and 5th, 2008.

1. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 521(a), 115 Stat. 38, 71 (codified as amended at 26 U.S.C. § 2010 (2006)).

2. The permanent exclusion results from section 1014 of the Internal Revenue Code of 1986, as amended. Section 1014 gives the decedent’s successor an income tax basis equal to the fair market value of the property at the estate tax valuation date for the decedent’s estate (which is usually the date of death). I.R.C. § 1014 (2006). There are two ways of fixing the problem. One is to recognize gains and losses (that have accrued to the transferor) at the date of gift or the transferor’s death. The other is for the decedent’s basis to carry over to the decedent’s successor, as currently occurs for inter vivos gifts under section 1015. *Id.* § 1015. I have endorsed recognition of gains and losses at transfer (with carryover-basis exceptions for spousal transfers and nonliquid assets). See Joseph M. Dodge, *Further Thoughts on Realizing Gains and Losses at Death*, 47 VAND. L. REV. 1827, 1829 (1994); Joseph M. Dodge, *Why a Deemed-Realization Rule for Gratuitous Transfers Is Superior to Carryover Basis and Avoids Most of the Problems of the Present Estate and Gift Tax*, 54 TAX L. REV. 421, 424 (2001).

approach”),³ or (3) enacting a transferee-oriented wealth transfer tax, which would be either a classic inheritance tax or an accessions tax. Although these three general approaches are not mutually exclusive,⁴ it is probably politically realistic to assume that only one could be adopted.⁵ Two of the five alternatives (the inheritance tax or carryover basis) are not worth serious consideration.⁶ Although I personally favor the income-inclusion approach,⁷ it would appear that the accessions tax would have the better chance of being enacted, partly because it looks like a mirror image of the estate tax system and partly because it would exempt all but the very rich.⁸ (In contrast, the inclusion-in-income approach would treat gratuitous receipts as gross income under the annual income tax, without any lifetime exemption or special rate structure.⁹)

3. Presently, gratuitous receipts are excluded under section 102, as well as by section 101(a), which excludes life insurance proceeds. I.R.C. §§ 101–102. The inclusion-in-income approach can be referred to as “repealing section 102.”

4. Fixing the gap in the income tax can be combined with a wealth transfer tax, because a wealth transfer tax is a separate tax apart from the income tax. The inclusion-in-income approach can be combined with a deemed-realization approach or a wealth transfer tax (really, a surtax on persons receiving very large amounts of gratuitous receipts). However, a carryover basis approach cannot be combined with either the inclusion-in-income approach or a transferee-oriented wealth transfer tax.

5. To my knowledge, no country combines an income tax solution with a wealth transfer tax. The deemed-realization approach was adopted in Canada only because of the repeal of Canadian federal transfer taxes. See generally Richard M. Bird, *Canada's Vanishing Death Taxes*, 16 OSGOODE HALL L.J. 133 (1978).

6. Since an inheritance tax is virtually the same as the estate tax (except for different rates and exemptions for different classes of legatees), it is not a meaningful alternative. For a critique, see *infra* text accompanying note 59. Carryover basis, see *supra* note 2, was enacted in 1976, but retroactively repealed in 1981. Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, § 401(a), 94 Stat. 229, 300. Another version of carryover basis, scheduled to take effect if estate tax repeal becomes permanent, is found in section 1023. See I.R.C. § 1023. Carryover basis operates erratically and capriciously in terms of trying to achieve any nontax goals, because the built-in gain bears no systematic correlation with the value of what is received. See Joseph M. Dodge, *What's Wrong with Carryover Basis, Especially the Carryover Basis Provisions of H.R. 8*, 91 TAX NOTES 961 (2001).

7. See Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 HARV. L. REV. 1177 (1978). Many other authorities endorse this approach. See generally, e.g., 1 REPORT OF THE ROYAL COMMISSION ON TAXATION (1966) (Can.); HENRY C. SIMONS, *PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY* 57–58 (1938); Charles O. Galvin, *Taxing Gains at Death: A Further Comment*, 46 VAND. L. REV. 1525, 1528–29 (1993); Marjorie E. Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gifts*, 25 CONN. L. REV. 1 (1992); John K. McNulty, *A Transfer Tax Alternative: Inclusion Under the Income Tax*, 4 TAX NOTES 24 (1976); Sergio Pareja, *Taxation Without Liquidation: Rethinking “Ability to Pay,”* 2008 WIS. L. REV. 841 (2008).

8. See Karen Burke & Grayson McCouch, *A Consumption Tax on Gifts and Bequests?*, 17 VA. TAX REV. 657, 658–90 (1998) (preferring accessions tax to income-inclusion approach for exempting all but the very rich). The senators at the Senate Hearing of March 12, 2008, appeared to be interested only in the accessions tax.

9. Under the inclusion-in-income approach, the distinction between included gifts and excluded support would need to be clarified, perhaps by an exclusion for certain marginal inter vivos gifts. Cf. I.R.C. § 2503(b)–(c), (e) (exclusion from gift tax of certain borderline gifts).

An accessions tax is a tax, distinct from the income tax, on the cumulative accessions (gratuitous receipts, however effected) of an individual *over such person's lifetime*. The cumulative tax base implies a progressive rate structure. All accessions tax proposals have featured a large per-taxpayer lifetime exemption. In contrast, under the income-inclusion approach, gratuitous receipts would be added to gross income in the year received, with no special exemption (other than a version of the gift tax annual exclusion). The accessions tax is collected on a pay-as-you go basis.

Example: Assume an accessions tax contains a \$2 million lifetime exemption and a progressive rate structure of 35% for the first \$3 million of taxable accessions above \$2 million, and a rate of 50% on all taxable accessions above \$5 million. Taxpayer X (an individual) receives the following gratuitous transfers (taxable accessions) in the years indicated, with the tax due also being indicated:

YEAR	TAXABLE ACCESSION	TAX
2010	\$1.5 million (bequest)	0
2013	\$1 million (gift)	\$175,000 (.35 multiplied by excess of cumulative tax base of \$2.5 million over exemption of \$2 million)
2020	\$2.5 million (life insurance proceeds)	\$925,000 (all in 35% bracket)
2021	\$3 million (bequest)	\$1.5 million (all in 50% bracket)

This Article aims to explain why an accessions tax is superior to the estate tax from both the policy and pragmatic angles. This Article parts with previous discussion of the accessions tax¹⁰ concept in fully developing the details of an accessions tax from the premise that it is a tax on gratuitous receipts.¹¹ An accessions tax that (like the income tax) incorporates a realization principle avoids the valuation problems that plague the current system.

10. The accessions tax has been advanced in a study by the American Law Institute (ALI). William D. Andrews, *Reporter's Study of the Accessions Tax Proposal*, in AM. LAW INST., FEDERAL ESTATE AND GIFT TAXATION: RECOMMENDATIONS ADOPTED BY THE AMERICAN LAW INSTITUTE AND REPORTERS' STUDIES 446, 446 (James A. Casner & William D. Andrews reporters, 1969) [hereinafter Andrews, *Reporter's Study*]; accord William D. Andrews, *The Accessions Tax Proposal*, 22 TAX L. REV. 589, 589-91 (1967) (describing the ALI accessions tax project); Edward C. Halbach, Jr., *An Accessions Tax*, 23 REAL PROP. PROB. & TR. J. 211 (1988); Harry A. Rudick, *A Proposal for an Accessions Tax*, 1 TAX L. REV. 25, 25-26 (1925); Lily L. Batchelder, *Taxing Privilege More Effectively: Replacing the Estate Tax with an Inheritance Tax* 7 (N.Y. Univ. Law and Econ., Working Paper No. 07-25, 2007), available at http://papers.ssrn.com/abstract_id=993314.

11. See Joseph M. Dodge, *Comparing a Reformed Estate Tax with an Accessions Tax and an Income-Inclusion System, and Abandoning the Generation-Skipping Tax*, 56 SMU L. REV. 551 (2003) (prior commentary on the accessions tax); see also Dennis L. Belcher & Mary Louise Fellows, Task Force on Federal Wealth Transfer Taxes, *Report on Reform of Federal Wealth Transfer Taxes*, 58 TAX LAW. 93, 279-312 (2004).

Part I deals with the reasons to change to an accessions tax; Part II deals with the placement of an accessions tax within the larger tax universe; Part III lays out the basic structural features of the accessions tax; Part IV covers timing (realization) and tax-avoidance issues.

I. THE REASONS FOR ADOPTING AN ACCESSIONS TAX

The estate tax is a tax on transferors, whereas the accessions tax is a tax on transferees. A move from the existing tax-on-transferor system to a tax-on-receipt system has strong theoretical and political appeal. This Part offers reasons for changing from an estate tax system to an accessions tax system.

A. THE PROBLEMS WITH THE EXISTING SYSTEM

This Article will not consider arguments that are raised against *all* taxes on gratuitous transfers, namely, that wealth transfer taxes either destroy existing capital or inhibit the creation of capital. There appears to be no consensus on these issues.¹² Moreover, since all taxes operate as a drag on the economy, the issue is whether wealth transfer taxes are inherently worse than other taxes at the margin in terms of economic efficiency, fairness, welfare, distribution of political power, and social justice.¹³

Instead, the focus here is upon arguments against the existing estate tax system that turn out to disappear or diminish when deployed against the accessions tax. These arguments are:

(1) the estate tax system does not cut down on concentrations of wealth;¹⁴

(2) the estate tax system is easy to avoid;¹⁵

(3) the estate tax system creates an incentive to enter into arrangements that destroy wealth, or at least create the appearance that wealth has been destroyed;¹⁶ and

12. See, e.g., Anne L. Alstott, *The Uneasy Case Against Income and Wealth Transfer Taxation: A Response to Professor McCaffery*, 51 TAX L. REV. 363, 385-90 (1996); Douglas Holtz-Eakins, *The Uneasy Empirical Case for Abolishing the Estate Tax*, 51 TAX L. REV. 495 (1996).

13. I avoid using the term "equity," because that term is often used to advance a particular concept of social arrangements, such as Utilitarianism, Libertarianism, or a Rawlsian approach.

14. See generally Gilbert P. Verbit, *Do Estate and Gift Taxes Affect Wealth Distribution?*, 117 TR. & EST. 598 (1978) (Part I); Gilbert P. Verbit, *Do Estate and Gift Taxes Affect Wealth Distribution?*, 117 TR. & EST. 674 (1978) (Part II). The problem with this hypothesis is that it is not known what the distribution of wealth would be in the absence a wealth transfer tax.

15. See George Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 COLUM. L. REV. 161, 162 (1977).

16. See, e.g., James R. Repetti, *Minority Discounts: The Alchemy in Estate and Gift Taxation*, 50 TAX L. REV. 415, 485-86 (1995).

(4) the costs under the estate tax system of administration, compliance, and planning are excessively large relative to the revenue obtained.¹⁷

Taking these arguments at face value, they overlap. The ineffectiveness of the estate tax system in terms of revenue yield and apparent lack of impact on concentrations of wealth is in part a function of the ease of avoidance, but such avoidance entails high planning and transaction costs, including that of disappearing wealth. Basically, these arguments boil down to the charge that the existing estate tax is ineffective, and ineffectiveness implies flaws of design and/or of execution.¹⁸

In addition, and cutting against the ineffectiveness hypothesis, a recurring political *leitmotiv* is that the existing tax causes the breakup of family farms and family business. Although the empirical aspect of this claim has been questioned in academic circles,¹⁹ it has taken on a political life of its own. Similar claims were instrumental in the abolition of estate-tax-type death duties in the United Kingdom, Canada, Australia, and New Zealand.²⁰ The theoretical aspect of this claim is that an estate tax is inconsistent with liberal principles by punishing successful entrepreneurship.²¹

The design flaw in the estate tax system is actually quite easy to identify. It is that the tax is imposed on the transferor at the time of transfer, rather than the transferees upon receipt (reduction to possession or enjoyment). This design flaw has had many unfortunate ramifications, which are spelled out in the remainder of this Article.

B. WHY TAXING THE TRANSFEREE IS BETTER POLICY THAN TAXING THE TRANSFEROR

The choice as to whether to tax transferees or transferors can be approached from several angles. One, of course, is revenue-raising potential, but revenue potential is considered in this Article to be neither a good or bad thing in itself,²² especially since the revenue-yielding

17. See, e.g., Joel C. Dobris, *A Brief for the Abolition of All Transfer Taxes*, 35 SYRACUSE L. REV. 1215, 1233-34 (1984).

18. See generally Stephen Vasek, *Death Tax Repeal: Alternative Reform Proposals*, 92 TAX NOTES 955 (2001) (setting forth alternative fixes, other than the accessions tax, to the present system).

19. See, e.g., James R. Repetti, *The Case for the Estate and Gift Tax*, 86 TAX NOTES 1493, 1494 (2000).

20. See David G. Duff, *The Abolition of Wealth Transfer Taxes: Lessons from Canada, Australia, and New Zealand*, 3 PITT. TAX REV. 72, 120 (2005).

21. See Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L.J. 283, 286-89 (1994).

22. Historically, wealth transfer taxes were considered to be an easy way to raise revenue, and were frequently deployed to help finance war. See Louis Eisenstein, *The Rise and Decline of the Estate Tax*, 11 TAX L. REV. 223, 225-34 (1956).

potential of wealth transfer taxes (compared to other taxes) is now considered to be slight,²³ given the political necessity of large exemptions designed to exclude all but the wealthiest taxpayers (transferors or transferees, as the case may be) from the tax. Thus, the focus herein will be on nonrevenue purposes.

A commonly-advanced rationale for the estate tax system is to curb excessive wealth concentrations.²⁴ But it is the income tax, not a wealth transfer tax, which operates to curb the accumulations of the earner as they occur.²⁵ Apart from the income tax, another possible tax that would curb wealth accumulations would be a progressive annual wealth tax.²⁶ The problem is that such a tax is probably unconstitutional in the United States as a nonapportioned direct tax that is not an income tax.²⁷ Although it is possible to reconstruct a wealth tax as an excise tax that might pass constitutional muster, such a tax would be extremely complex.²⁸ A federal wealth *transfer* tax avoids constitutional infirmity on the ground that it is a nondirect (excise) tax.²⁹ However, a wealth transfer tax is not a tax on the accumulation itself but only on what is left over of accumulated wealth at the death of the accumulator.

In any event, penalizing accumulations of wealth—an aspect of the American dream—is not particularly popular as a political goal, and it is suspect from the vantage point of liberal theory.³⁰ Even if curbing accumulations were an accepted goal, the estate tax is a poor mechanism for achieving it. The estate tax, as a tax “on” the transferor’s wealth, can

23. Since 1978, the federal transfer taxes have only raised between 1% and 1.5% of federal revenues. See Batchelder, *supra* note 10, at 5 (citing Office of Management and Budget figures from 2006). Professor Duff argues that elimination of moderate estates through a large exemption is essential to the political acceptability of the tax. Duff, *supra* note 20, at 118.

24. See, e.g., James R. Repetti, *Democracy, Taxes, and Wealth*, 76 N.Y.U. L. REV. 825, 827–28 (2001).

25. The federal transfer taxes are sometimes supported on the ground that they add progressivity to the income tax. See Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L.J. 259, 271–73 (1983). But the transferor incurs no burden with respect to the estate tax, and the burden on legatees not only bears no relation to lifetime income but also the effective estate tax rate (estate tax divided net estate) may be lower than effective income tax rates.

26. The Spring and Summer 2000 issues of *Tax Law Review* are, in their entirety, devoted to personal wealth taxes. See generally *Symposium on Wealth Taxes Part I*, 53 TAX L. REV. 257 (2000); *Symposium on Wealth Taxes Part II*, 53 TAX L. REV. 499 (2000).

27. See *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 607–08 (1895) (reaffirming that an unapportioned federal tax on real estate would be unconstitutional), *vacated*, 158 U.S. 601, 637 (1895) (holding that a nonapportioned tax on personal property is unconstitutional).

28. See Joseph M. Dodge, *The Taxation of Wealth and Wealth Transfers: Where Do We Go After ERTA?*, 34 RUTGERS L. REV. 738, 774–75 (1982) (proposing a wealth tax that takes the form of a wealth transfer tax).

29. See *Knowlton v. Moore*, 178 U.S. 1, 82–83 (1900); *Scholey v. Rew*, 90 U.S. 331, 346 (1875).

30. See Edward J. McCaffery, *The Political Liberal Case Against the Estate Tax*, 23 PHIL. & PUB. AFF. 281, 296 (1994). Cf. Eric Rakowski, *Can Wealth Taxes Be Justified?*, 53 TAX L. REV. 263 (1998) (stating that application of liberal principles leads to rejection of annual wealth tax but acceptance of wealth transfer tax).

be characterized as a “second” tax (in addition to the income tax) on a testator’s hard-earned success in the market economy. The estate tax can not only be characterized as a tax on “success” but even more specifically as punishment laid on the wealthy who saved as opposed to those wealthy who consumed, despite a value system that purports to value savings relative to consumption.³¹ Furthermore, the estate tax falls on wealth at the very moment when such wealth might be in the process of dispersal “by natural causes,” that is, the preferences of the decedent (as opposed to the wealth transfer tax itself).³² Finally, the estate tax, being “caused” by the death of the wealth-holder, is susceptible to being characterized as a tax on death itself rather than a tax on the transfer of wealth.³³

The better nonrevenue reason to impose a wealth transfer tax would be to attack the problem of excessive *inherited* wealth.³⁴ Apart from surviving spouses (and possibly children working in family enterprises), gratuitous accessions are, from the recipient’s point of view, *unearned* financial windfalls.³⁵ If a wealth transfer tax is to possess any kind of political traction it would be as a tax on the *undeserved* financial advantage enjoyed by (well-off) gratuitous transferees.³⁶ Unlike earned financial advantages (salary and business profits), such advantage is otherwise not taxed to the acquirer,³⁷ and, in the case of unrealized appreciation, has not been taxed to any taxpayer.³⁸ Finally, a transferee-oriented wealth tax is indeed a tax on the accumulation (rather than disposition) of wealth. If, as is probably the case, inherited wealth is a significant component of individual wealth accumulation generally,³⁹ then

31. See MICHAEL J. GRAETZ & IAN SHAPIRO, DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH 41–42 (2005). For an attack on the notion that savings is a liberal value, see Alstott, *supra* note 12, at 368–82.

32. Equality of distribution to children (rather than primogeniture or unequal distribution) is overwhelmingly the dominant bequest pattern in the United States. See Paul L. Menchik, *Primogeniture: Equal Sharing and the U.S. Distribution of Wealth*, 95 Q.J. ECON. 299, 314 (1980).

33. See GRAETZ & SHAPIRO, *supra* note 31, at 74–84.

34. See Mark L. Ascher, *Curtailing Inherited Wealth*, 89 MICH. L. REV. 69, 149 (1990); David G. Duff, *Taxing Inherited Wealth: A Philosophical Argument*, 6 CAN. J. L. & JURIS. 3, 62 (1993); Eisenstein, *supra* note 22, at 253.

35. Liberal theorists opposed to wealth taxes (other than Edward McCaffery) favor wealth transfer taxes on this basis. See Liam B. Murphy, *Liberty, Equality, Well-Being: Rakowski on Wealth Transfer Taxation*, 51 TAX L. REV. 473, 474 (1996); Eric Rakowski, *Transferring Wealth Liberally*, 51 TAX L. REV. 419, 462–71 (1996).

36. See BRUCE ACKERMAN & ANNE ALSTOTT, THE STAKEHOLDER SOCIETY 97–100 (1999); Duff, *supra* note 20, at 119–20.

37. See *supra* text accompanying note 3.

38. Section 1014 confers a value-at-death basis rule for property included in a decedent’s gross estate, even if no estate tax is due. This rule has the effect of permanently eliminating unrealized gains of a decedent from income tax. See I.R.C. § 1014 (2006).

39. Studies show that inherited wealth constitutes a significant portion of wealth accumulations. See, e.g., JOHN A. BRITAIN, INHERITANCE AND THE INEQUALITY OF MATERIAL WEALTH 14–16 (1978); C. RONALD CHESTER, INHERITANCE, WEALTH, AND SOCIETY 4, 77–81 (1982); Laurence J. Kotlikoff &

the curbing of inherited wealth would be somewhat efficacious in curbing excessive wealth concentrations generally.⁴⁰

The estate tax system is only modestly effective as a remedy to the problem of excessive concentrations of inherited wealth, because, given the legal principle of freedom of testation, there is little to prevent the bequest of the entire (after-tax) estate to a single favored legatee.⁴¹ In contrast, an accessions tax directly operates to reduce the net accessions (unearned wealth) received by a gratuitous transferee.⁴² Moreover, the *relative* tax burden increases as one's lifetime accessions increase. In contrast to the estate tax, which (apart from the marital and charitable deductions) is indifferent to how wealth is disposed of, a progressive accessions tax operates as a direct incentive for the dispersal of wealth, in order to take advantage of the exemptions and lower marginal rates of such individuals.⁴³

The "fit" between the accessions tax and the goal of dispersing unearned wealth should not be underestimated by characterizing dispersal as merely an appealing by-product of an accessions tax. Given the relatively low revenue ambitions of wealth transfer taxes, the nonrevenue goal of dispersal rather becomes a foundational justification for an accessions tax. Against the argument that dispersal is likely to occur anyway,⁴⁴ it can be answered that the dispersal incentive of an accessions tax is much broader than that of the "normal" dispersal pattern, namely, equal bequests to children. Moreover, an accessions tax provides an incentive for *unequal* distributions to persons on the basis of need (at least in terms of inherited wealth) rather than standard verbal formulas such as "*per stirpes*." The accessions tax places a premium on flexibility obtainable through discretionary trusts and powers of appointment, thereby loosening the grip of the dead hand.

Lawrence H. Summers, *The Role of Intergenerational Transfers in Aggregate Capital Accumulation*, 89 J. POL. ECON. 706, 729 (1981); Edward N. Wolff, *Changing Inequality of Wealth*, 82 AM. ECON. REV. 552, 557 (1992). Estimates of the portion of wealth attributable to inheritance range from 20% to 80%. See Paul L. Menchik & Nancy Jianakoplos, *Economics of Inheritance*, in INHERITANCE AND WEALTH IN AMERICA 45 (Stephen J. McNamee & Robert K. Miller, Jr. eds., 1998). For a theoretical discussion, see Stephen J. McNamee & Robert K. Miller, Jr., *Inheritance and Stratification*, in INHERITANCE AND WEALTH IN AMERICA, *supra*, at 193.

40. The degree of wealth concentration (without regard to source) is quite high: the top 1% of the population owns about 37% of household wealth. See Edward N. Wolff, *Recent Trends in Household Wealth in the United States: Rising Debt and Middle-Class Squeeze* 11-12 tbl.2 (Levy Econ. Inst., Working Paper No. 502, 2007).

41. See Batchelder, *supra* note 10, at 9. A bequest of an entire estate to a single trust may or may not be viewed as "wealth concentration."

42. The accessions tax is paid by the transferee. For a discussion of the burden of the tax, see *infra* note 64.

43. See Batchelder, *supra* note 10, at 8.

44. See discussion *supra* note 32.

Finally, an accessions tax appeals to notions of formal equity: equally-situated taxpayers (in terms of lifetime gratuitous receipts) will be taxed equally.⁴⁵ In contrast, recipients of gratuitous receipts are taxed unequally under the estate tax. A person is worse off receiving a bequest from a large estate (incurring a substantial tax) than an equal aggregate amount from several smaller estates (incurring little or no tax).⁴⁶ Moreover, equal legatees from a single estate may be treated unequally under the estate tax due to the unequal apportionment of estate taxes among the various legacies.

C. WHY AN ACCESSIONS TAX IS LIKELY TO BE PREFERRED TO AN INCOME-INCLUSION APPROACH OR A CLASSIC INHERITANCE TAX

This section examines the issue of why an accessions tax would be favored over an income-inclusion approach or a classic inheritance tax. The nature of an accessions tax carries certain implications for the exemption level and rate schedule.

1. *Why a Separate Tax on Transferees?*

From an ability-to-pay perspective, gratuitous receipts are accessions to wealth that should be included in the recipient's annual income tax base without exemption or exclusion by reason of source.⁴⁷ But an accessions tax (in contrast to an income-inclusion system) has a significant lifetime exemption and a separate rate structure applicable to a lifetime tax base. What is the key to this difference, and why does the accessions tax appear to have broader appeal in this respect? The answer must lie (in part) on a reluctance (by society and political agents) to view gratuitous receipts as "income." Part of this reluctance could stem from cognitive inertia: gratuitous receipts have been excluded throughout the history of the modern income tax.⁴⁸ In addition, non-ability-to-pay concepts of income exclude gratuitous receipts.⁴⁹ Finally, there is a

45. An exception to this generalization would appear to lie for surviving spouses if accessions by them from their deceased spouses are tax free. See *infra* Part III.

46. Each estate has a separate exemption amount.

47. Gratuitous receipts constitute an increase in the recipient's ability-to-pay tax base to the same extent as wages, lottery winnings, or any other accession to wealth. There is no internal-to-tax reason why a gratuitous transfer should bear a lighter tax than wages paid for a personal service (such as a home repair): in both cases, the transferee has income and the transferor has a nondeductible expense.

48. Section 102(a), which excludes gratuitous receipts, traces its lineage back to the first modern (1913) income tax. Act of Oct. 3, 1913, ch. 16, Pub. L. No. 16, § 2, 38 Stat. 114, 167. An exception to the exclusion lies for rights to "income in respect of a decedent," but these have not yet been subject to income tax. I.R.C. § 691(a) (2006).

49. Transfers in general are excluded from "economic" income, which is the product of capital and labor. This view of income was once endorsed by the Supreme Court. See *Eisner v. Macomber*, 252 U.S. 189, 189 (1920). The current doctrinal concept of income is aligned with the ability-to-pay concept. See *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 432 (1955). Trust accounting and financial accounting concepts of income, which may have been influential at the creation of the modern income tax in 1913, treat gratuitous receipts as "capital" in the nature of original endowment. UNIF. PRINCIPAL

perception that the income tax exclusion avoids a second tax on income that has already been taxed within the family. Of course, the second-tax argument is factually problematic, because unrealized appreciation is never subject to income tax under current law.⁵⁰ On the other hand, that problem can be dealt with discretely without imposing any double tax on income.⁵¹ Conceptually, the double-taxation argument is problematic because the gratuitous transferee is a separate taxpayer apart from the transferor of previously-taxed wealth. Basically, the double-tax argument privileges families relative to individuals, and on that account is deeply anti-egalitarian.⁵² It is perhaps sufficient for present purposes to acknowledge this point as a social practice, without examining whether it is justified.⁵³

Assuming that the double-taxation idea explains the reluctance of the government to seriously consider the income-inclusion approach, how can a wealth transfer tax (another form of double taxation) rise to the level of respectability? Here the concept of an exemption is crucial: double taxation is acceptable for the very rich,⁵⁴ perhaps (in part) because of a suspicion that the very rich find ways to avoid the full measure of the income tax.⁵⁵ Granting such a limited scope to double taxation, the issue is whether the second tax should be on the transferor or the transferee. Since the economic burden of a wealth transfer tax falls on the transferees regardless of the form of the tax, the tax might as well be designed so as to impose this burden explicitly and rationally.⁵⁶

& INCOME ACT § 3(b) (amended 1997), 7B U.L.A. 145 (2000). Cf. *Edwards v. Cuba R.R. Co.*, 268 U.S. 628, 633 (1925) (holding that nonshareholder contribution to capital was not income to a corporation).

50. See discussion *supra* note 2.

51. The two means of targeting this problem are described *supra* note 2.

52. See U.S. DEP'T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM 36-38 (1977) (pointing out that the income exclusion results from viewing the family as the taxable unit). David Duff argues that the family idea only justifies a support exclusion, an exclusion for interspousal transfers, and special rules for family assets having a "way of life" character or sentimental value. See Duff, *supra* note 34, at 58-62.

53. Double taxation within the family raises certain economic issues that are not present in other double-taxation scenarios. See Joseph M. Dodge, *Taxing Gratuitous Transfers Under a Consumption Tax*, 51 TAX L. REV. 529, 561-88 (1996) (considering, and rejecting, economic and other arguments against double taxation of gratuitous transfers).

54. See Duff, *supra* note 20, at 118-20 (arguing that the lifetime exemption concept is a political necessity).

55. Unrealized appreciation, exempt from income tax by reason of section 1014, see I.R.C. § 1014 (2006), and otherwise taxed at low capital gains rates, is held predominately by the wealthiest segment of society. See Edward N. Wolff, *Who Are the Rich? A Demographic Profile of High-Income and High-Wealth Americans*, in DOES ATLAS SHRUG? 74, 91 (Joel B. Slemrod ed., 2000) (noting that in 1992, the top 1% owned over 50% of wealth taking the form of securities, business equity, and real estate other than the principal residence). Assets held predominantly by the bottom 99% (principal residence, bank deposits, life insurance, and pensions) do not (except for residence gains in excess of the exempt \$250,000) benefit from section 1014 or capital gains treatment. *Id.*

56. See CARL SHOUP, FEDERAL ESTATE AND GIFT TAXES 29-31 (1966).

Cognitive inertia also favors the accessions tax over the inclusion-in-income type of transferee tax, because the accessions tax appears (somewhat inaccurately) to be just like the existing estate tax system in reverse: it is a tax on a cumulative lifetime tax base (subject to a substantial lifetime exemption), except that it applies to transferees rather than transferors. Like the existing estate tax, it impacts only the very rich.

The explicit transferee perspective of the accessions tax deflects the double-taxation argument leveled against the estate tax, because the transferee is a different taxpayer than the person previously subject to income tax. Furthermore, the fact that the taxable event under a “realization” accessions tax is the receipt of cash or liquid assets, rather than the receipt of property interests, creates a (potential) timing gap between the transfer and the accession such that the accession item (cash or a liquid asset) might differ from the transferred item (a trust or a closely-held business interest). From an economic perspective, a transferor’s wealth accumulation behavior would be less influenced by taxes that could be deferred well after death (as can occur under the accessions tax) than taxes imposed no later than death. From the transferee’s perspective, a tax on unearned income would counter the Carnegie hypothesis that the acquisition of unearned wealth creates an incentive on the beneficiary not to work (or to take early retirement).⁵⁷ The transferee also has little incentive to engage in tax avoidance behavior, since the tax is always less than (but imposed at the same time as) actual economic enjoyment.

2. *Why Not a Classic Inheritance Tax?*

An accessions tax is preferable to a classic inheritance tax in its ability to achieve equity among gratuitous transferees with respect to the subject of the tax. Under an inheritance tax, each decedent’s estate is treated separately, and multiple exemptions and differential rates can favor some persons relative to others.⁵⁸ Moreover, the formal relationships that determine the rate and exemption schedules may not reflect the “closeness” of the legatee to the decedent. Nor is it clear that formal degree of relationship bears any rational relationship to any purpose of a federal wealth transfer tax.⁵⁹ Taxing remote legatees more heavily than close legatees can be viewed as a kind of watered-down

57. See generally Douglass Holtz-Eakin et al., *The Carnegie Conjecture: Some Empirical Evidence*, 108 Q.J. ECON. 413 (1993).

58. Lily Batchelder refers to the accessions tax as an “inheritance tax.” Batchelder, *supra* note 10, at 10. Presumably, this move—although confusing to those literate in tax jargon—is to help sell the idea to the masses. Classic inheritance taxes were usually imposed only on probate estates, omitting gratuitous receipts by way of gifts, life insurance, contract rights, and joint tenancies. See RANDOLPH E. PAUL, *TAXATION IN THE UNITED STATES 15–17* (1954).

59. See Batchelder, *supra* note 10, at 47–48.

escheat, but escheat is an interest unique to the states. An inheritance tax has all the defects of an estate tax in terms of valuation, liquidity, and vulnerability to tax avoidance.

3. *What Should the Exemption Level Be?*

The exemption level of an accessions tax might well be reflexively carried over from the existing system. Currently, a married couple has two estate tax exemptions.⁶⁰ Since the fertility rate of women in the U.S. is about 2.0,⁶¹ the per-transferor exemption system of current law readily converts to an equal per-transferee exemption system ($2 = 2$).

Another possible approach to setting the exemption level is to identify a percentage of the population that possesses a disproportionately high share of wealth (or of unearned wealth)—say, 1%—and fashion an exemption level that targets only this group. A third possible approach—suggested by the fact that most large accessions are received by persons in their fifties and sixties—would be to exempt that amount, which would provide a comfortable retirement annuity for a person aged, say, sixty-seven. All of these approaches are imprecise, but converge somewhat in suggesting an exemption level in the range of \$1.5 to 3 million per person.⁶²

4. *What Should the Rate Schedule Look Like?*

The current estate tax combines a virtual flat rate with a large exemption.⁶³ Since the tax (if any) is laid on the entire distributable estate (and considering that the decedent has the ability to control the burden of the taxes), it is rational for all interested parties to view the burden of the tax in average-rate terms rather than marginal-rate terms. So viewed, the estate tax flat-rate scheme is sensible, because the high rate combined with the large exemption operates as a progressive tax with

60. Each of husband and wife is a decedent, on whose estate a tax is imposed by section 2001(a). I.R.C. § 2001(a) (2006). The exemption, which takes the form of a credit, *see* I.R.C. § 2010, is available for the estate of any decedent.

61. The estimated rate for U.S. women in 2009 is 2.05. *See* Central Intelligence Agency, *The World Factbook—Country Comparisons, Total Fertility Rate*, <https://www.cia.gov/library/publications/the-world-factbook/rankorder/21127rank.html> (last visited May 17, 2009).

62. An exemption level under the estate tax of \$2 million in 2008 is estimated to result in tax being paid by 0.76% of decedents' estates, and raising the exemption to \$3.5 million in 2009 is estimated to reduce the percentage of taxed estates to 0.39% (but decreasing revenue yield from \$27 billion to \$21.8 billion). *See* STAFF OF JOINT COMM. ON TAXATION, 110TH CONG., HISTORY, PRESENT LAW, AND ANALYSIS OF THE FEDERAL WEALTH TRANSFER TAX SYSTEM 29 (2007). An annuity of \$200,000 per year for a person age sixty-seven is worth \$1.85 million, using a 6% discount rate. *See* IRS, U.S. DEP'T OF THE TREASURY, PUBL'N NO. 1457, ACTUARIAL VALUES: BOOK ALEPH 1-100 tbl.S (1999). Batchelder, *supra* note 10, at 19, suggests an exemption of \$2.3 million, based partly on current law and partly on the observation that an inheritance of this amount at age twenty would (at 5%) support an annuity that would generate an annual return in the ninetieth percentile of income in the United States.

63. In the 2007 to 2009 window, the estate tax rate is a flat 45%. The gift tax effectively has a 41% rate bracket, because the gift tax exemption is only \$1 million, whereas the estate tax exemption is no less than \$2 million starting in 2007. *See* I.R.C. §§ 2001(c), 2010, 2505.

gradually rising progressive *average* rates. Under the accessions tax, in contrast, a high flat rate coupled with a large exemption would strongly influence distributions from discretionary trusts and the making of other discretionary gratuitous transfers.⁶⁴ Thus, the way to translate the flat-rate, large exemption structure of the current system to an accessions tax would be to lower the exemption level to somewhere in the range of only \$1 to 1.5 million, and combine that with a rate structure that starts at a fairly low rate (say, 10%) and is graduated upward in relatively small steps. Since accessions are really income (accessions to wealth) of the recipients,⁶⁵ the marginal rates (and even the brackets) could mimic those of the income tax at lower levels.⁶⁶ Yet, given the purpose to curb undue concentrations of unearned wealth, there is good reason for the rate schedule to progress beyond the highest income tax rate (currently, 35%) to a really high top rate (say, 90% for cumulative taxable accessions in excess of \$10 million). High marginal rates can, of course, be avoided by dispersal of wealth and transfers to charities.⁶⁷

D. ADMINISTRATION OF THE ACCESSIONS TAX

Before proceeding further, it is necessary to consider the issue of whether or not an accessions tax can be administered and enforced. Probably the biggest advantage that an estate tax system enjoys relative to an accessions tax is that the donor and estate is a centralized reporting and collection agency. Moreover, except in a few cases,⁶⁸ it is not necessary to determine how much each transferee receives. In contrast, an accessions tax requires that the net amount received by each person be determined. Furthermore, reporting and tax-payment obligations would lie with the persons receiving accessions, not the donor or estate of the decedent. Since the accessions tax base is cumulative, each person would have to keep track of accessions over that person's lifetime.

Notwithstanding these complications, administration of an accessions tax is feasible. Gratuitous transfers would be reported to the U.S. Internal Revenue Service (IRS) and transferees by transferors (donors) and third parties (estate representatives, trustees, insurance

64. The effect of marginal rates on the transferees would be sharpened by the fact that the allocation of the burden of an accessions tax cannot be easily controlled by the decedent.

65. See discussion *supra* note 47.

66. See Batchelder, *supra* note 10, at 16 (suggesting using the recipient's highest marginal income tax rate plus 15% in any given year).

67. It could be argued that the strongest incentive for wealth dispersal would be precisely to combine a large exemption with a fairly high flat rate (say, 50%). Such a system would "force" donors and decedents to fully use the accessions tax exemptions of as many persons as possible. However, after such exemptions were fully used up, there would be no further tax incentive for dispersal. Only a system of full graduation to a very high rate can operate as a dispersal incentive across the board.

68. Valuation of what the transferee receives is required where the transfer qualifies for the marital or charitable deductions or the gift tax present-interest exclusion.

companies, securities and real estate brokers, etc.).⁶⁹ Transferees would compute the accessions tax owed pursuant to a schedule accompanying the income tax return,⁷⁰ and the net tax would be entered on a separate line of the individual income tax return (Form 1040) in the "Other Taxes" section on page two. Using the income tax return as the reporting vehicle is appropriate, because the accessions tax is really a "scheduler" component of a comprehensive income tax, just like the tax on net capital gains.

The most difficult task for the taxpayer would lie in retrieving the amount of her cumulative lifetime accessions prior to the current reporting year. It would be onerous to require individuals to maintain a collection of Form 1040s going back to the date of birth. Since there is no single third party who would have access to all relevant information, the IRS itself would be left as the only feasible repository of this information. A taxpayer's past accessions tax information could be made accessible by a secure computer account. Also, a printed version should be mailed by the IRS to the person, just as the Social Security Administration prepares a history of Federal Insurance Contributions Act ("FICA") taxes paid.

An issue is whether the tentative accessions tax should be withheld by transferors and their agents.⁷¹ Because of the large lifetime exemption and the withholding agent's ignorance of the transferee's accessions tax history, any attempt at accuracy (as occurs with wage withholding under the income tax) would be futile. Accordingly, the withholding rate should be a uniform flat rate⁷² that is low enough so as to not cause major inconvenience to the mass of zero- or low-bracket transferees, but high enough to create incentives for transferees to honestly fill out the accessions tax schedule. These considerations suggest that the flat rate should be at least 10% but not more than 30%.

II. THE PLACE OF THE ACCESSIONS TAX IN THE TAX UNIVERSE

This Part deals with basic structural features of the accessions tax that "locate" the tax in the tax universe. Topics dealt with herein are whether the tax is more closely related to an income tax or a wealth tax,

69. Cf. I.R.C. § 6045 (2006 & Supp. II 2008) (basis information required to be reported by brokers, donees, heirs, and securities issuers).

70. Husbands and wives would be separate taxpayers for accessions tax purposes despite filing a joint income tax return. The accessions tax schedule would provide for separate computations by husbands and wives.

71. No withholding tax would be payable on a transfer to a trust. The trustee would be the withholding agent on a distribution to a beneficiary.

72. An analogy is the source-based tax on investment income of nonresident aliens, the rate of which is 30% under section 871(a). I.R.C. § 871(a). The 30% rate is often reduced or waived under income tax treaties. See 2006 United States Model Income Tax Convention, Nov. 15, 2006, art. 10, cl. 2, available at <http://www.ustreas.gov/press/releases/reports/hp16801.pdf>.

the relation to foreign successions taxes, the relation to the existing system (i.e., transition), and the relation to the income tax.

A. THE ACCESSIONS TAX IS NOT A STEALTH WEALTH TAX

For better or worse, an accessions tax should not be considered a periodic wealth tax, as the estate tax system is often viewed on account of the fact that the latter is imposed on the entire terminal value of the accumulated wealth of a transferor, regardless of how such wealth is obtained. An accessions tax is not a tax on the total wealth of any person, but only on the accessions to wealth from a certain source that happen to be exempt from the income tax. In the abstract, there is no reason to tax wealth periodically, as wealth has no (nonrevenue) significance apart from who owns it and how it is acquired.

At least two prominent features of the existing system would be omitted from an accessions tax. One is a generation-skipping tax, which is aimed to prevent avoidance of tax at generational intervals.⁷³ The other is the credit for previously-taxed transfers (section 2013), the purpose of which is to mitigate the effect of transfer taxes that are imposed in close succession.⁷⁴ An accessions tax is a tax on cumulative gratuitous receipts, and the generational source of the receipt is irrelevant. Just as taxation at infrequent intervals is not a concern, so taxation at “too frequent” intervals is not a concern. Too-frequent taxation can be avoided by bequests conditioned on survival, disclaimers that bypass a generation, and trusts that delay distributions. The exclusion for interspousal transfers would avoid the most common potential occurrence of the successive-transfers problem.

B. UNITED STATES AND FOREIGN TAXPAYERS

Citizens and residents of the United States would be taxed on all accessions received, regardless of source. The nationality of the transferor and the situs of property, estates, and trusts would be irrelevant.

The country other than the United States may (by reason of the nationality of the transferor or the situs of property) impose a successions tax on property that is also (currently or subsequently) subject to U.S. accessions tax. The resulting double taxation might be

73. The ALI study would have imposed a higher rate on accessions from grandparents and other “remote” relatives. Andrews, *Reporter's Study*, *supra* note 10, at 460–64. Under an estate tax, the generation-skipping problem is most apparent in the scenario where *A* creates a trust, income to *B* for life, remainder to *C*, because no estate tax is imposed on the trust (or, to the extent that *B* consumes the income, on *B*'s personal estate) at *B*'s death. Under an accessions tax, in contrast, distributions to *B* are included in the accessions tax base of *B*, regardless of how *B* disposes of the distributed amounts.

74. The ALI study contained a version of section 2013 that retroactively excludes an accession (according to a sliding scale) received within ten years of the taxpayer's death. *Id.* at 501–05.

resolved by treaty or the tax law of either country, but conceptually the problem is identical to the transition problem.⁷⁵ However, the solutions need not be the same in the two situations. In the international setting, the United States should decline to adopt an exemption approach, because otherwise it might be possible to totally avoid U.S. accessions tax by incurring a nominal foreign successions tax or even making bequests "subject to" a foreign successions tax but not producing any actual tax. Thus, a credit approach is to be preferred.

The United States would have the option of asserting "source" jurisdiction to impose accessions tax on nonresident aliens who receive accessions from sources in the United States.⁷⁶ However, the United States would have no knowledge of the cumulative accessions of a foreign person from worldwide sources, and therefore the tax would serve the U.S. policy purpose of curbing undue accumulations of unearned wealth only haphazardly. Nevertheless, the U.S. Treasury would be able to generate some additional revenue by taxing gratuitous transfers to foreign persons from U.S. sources (however defined).⁷⁷ Any such tax (which is really an estate tax) would necessarily be at a flat rate, although a per-estate exemption is possible. Foreign countries would be expected to request that the United States enter into treaties that reduce or eliminate such a tax.

C. TRANSITION

Since the present system taxes gratuitous transfers and the accessions tax reaches gratuitous receipts, the transition norm is straightforward: the accessions tax should not be imposed on transfers that were previously subject to the estate and gift taxes. The only available options, in theory, are an exclusion from accessions tax for items previously subject to estate or gift tax or a credit for prior gift and estate taxes paid.⁷⁸ However, there is no fair way of allocating any prior (gift or estate) tax to an accession that takes the form of a trust distribution.⁷⁹ Also, a credit should not be allowed unless the accession

75. See discussion *infra* Part II.C.

76. Cf. I.R.C. §§ 2101-2107 (2006) (imposing estate tax on certain U.S. property of a nonresident-alien decedent).

77. In this context, "U.S. source" could be determined by the status of the decedent, the location of the property, or both.

78. A possible model for such a credit is current section 2013, providing a credit against current estate tax for the estate tax "on" the "same property" in the hands of a recent prior decedent. See I.R.C. § 2013.

79. Trust assets are taxed on distribution, not receipt by the trust. A fair allocation of prior estate or gift tax to trust distributions would presuppose knowledge of the aggregate amount of all distributions from the trust, but that amount cannot be known until the trust terminates. However, fairness may not be so important in the transition context. The credit could be set at so many cents per dollar of distribution, based on the ratio of the tax "on" the trust divided by the inception value of the trust. The credit with respect to the trust would be exhausted at the point when aggregate distributions

actually produces accessions tax, and even then it is doubtful that the credit should be a refundable one.

Thus, the exemption approach is the more appealing alternative as a transition principle. Accordingly, an accession of an amount that was included in the estate and gift tax base would be excluded from accessions tax.⁸⁰ Specifically, gratuitous receipts derived from transfers of decedents dying before the cut-off date would be exempt, as would gratuitous receipts derived from wholly completed gifts (made by persons who are alive at the cut-off date) made before the cut-off date.

An exception would lie for gratuitous receipts derived from transfers made prior to the cut-off date that are incomplete for transfer tax purposes but are in a form that would trigger taxation later, such as transfers with retained interests and powers⁸¹ and transfers that qualified for the gift or estate tax marital deduction.⁸² Nevertheless, any distributions to the transferor's spouse from a pre-cut-off-date trust to the transferee spouse after the cut-off date would qualify for the accessions tax spousal exclusion. A similar rule would apply in the case of split-interest charitable transfers.⁸³ These rules would have the cumulative effect of avoiding any carryover of the current system following the cut-off date.

The cut-off date (the date the estate tax system disappears and is replaced by the accessions tax) should be fixed at an early enough date to prevent transferors from rushing to make exempt or low-taxed transfers under the estate tax system solely to obtain transition-rule exemption under the accessions tax.

equaled such inception value.

80. An analogy is the exclusion ratio concept that operates under the generation-skipping tax (GST). See I.R.C. §§ 2631–2632. A generation-skipping trust that is fully covered by the GST exclusion at its inception is never subject to the GST, even if the trust, at any given generation-skipping transfer, has grown to an amount that exceeds the initial exclusion amount. This solution is apt to the transition problem, because the aggregate accessions tax base resulting from gratuitous transfers by a person will (due to various deferral rules described in Part IV) certainly be greater (or lesser) than the cumulative estate and gift tax base of the same person.

81. Certain inter vivos transfers are not completed gifts for gift tax purposes. See Treas. Reg. § 25.2511-2 (1999). Such transfers may become completed gifts of the donor at a later time or, if not, will be included in the donor's gross estate under sections 2036 through 2038. See I.R.C. §§ 2036–2038.

82. Transfers of interests that avoid gift or estate tax to the transferor under the marital deduction must be in a form that causes inclusion of the property in the tax base of the transferee spouse under sections 2033, 2041, 2044, 2511, 2514, or 2519. See I.R.C. §§ 2033, 2041, 2044, 2511, 2514, 2519.

83. Under current law, charitable future interests are deducted under section 2055 or section 2522, if the requirements of section 664 are satisfied. See *id.* §§ 664, 2055, 2522 (2006 & Supp. I 2007).

D. COORDINATION WITH THE INCOME TAX

The income-tax basis issue is independent of the accessions tax. If section 1014 were retained after adoption of an accessions tax, it would need to be modified to reflect the various delayed-transfer rules under the accessions tax applicable to estates, trusts, and certain hard-to-value assets, because obtaining a basis step up before the asset is subject to accessions tax would be unwarranted.⁸⁴ In addition, since gratuitous receipts of the transferor's spouse would be exempt from accessions tax (on the theory that the property was that of the transferee spouse all along), the spouse should not obtain a section 1014 basis, but instead should take over the property's existing basis.

On the other hand, section 1014 could be repealed,⁸⁵ in which case income tax on unrealized gain would be imposed prior to, simultaneously with, or subsequent to the imposition of accessions tax on that property.⁸⁶ Whatever the sequence, one of the taxes would reduce the tax base under the other tax.⁸⁷

One final observation is that the accessions tax can "hand off" to the income tax in certain delayed transfer-of-in-kind-asset situations, because both taxes are on transferees. To illustrate, suppose that *T* bequeaths an expensive automobile to *X*, and that this kind of bequest is exempt from accessions tax so long as *X* holds the car for personal use. If *X* subsequently sells the car for, say, \$30,000, the exemption disappears. At this point there is a design option to treat *X* as having (a) an accession of \$30,000, or (b) gross income (or even capital gains) of \$30,000. The income (or capital gains) option would result from assigning *X* an income tax basis of zero.

III. THE ACCESSIONS TAX BASE

This Part covers the principal issues relating to the accessions tax base other than those that involve trusts, successive interests, and rights to future payments, which are dealt with in Part IV. The gross tax base is the aggregate value of an individual's gratuitous receipts of all kinds, regardless of the recipient's relationship (if any) to the transferors. The net tax base is the gross tax base reduced by the recipient's costs of obtaining, transmitting, and processing items included in the gross tax base. The receipts are included when received in cash or in reasonably

84. Delaying the basis adjustment would also avoid having to value the asset twice.

85. See discussion *supra* note 2.

86. The income tax might be imposed subsequent to the accessions tax if a carryover basis rule is adopted.

87. Under current law, the income tax on the transferor generally reduces the estate tax base. In the case of rights to income in respect of decedent (IRD rights), the estate tax (which "comes first") is a deduction against the income tax (which comes later). See I.R.C. § 691(c) (2006). For a further discussion of this problem in the accessions tax context, see *infra* text accompanying notes 183-84.

liquid form (i.e., when realized). There are exclusions for accessions from spouses and for support and payments by one person for another person's consumption.

A. GENERAL DEFINITION OF "ACCESSION"

The accessions tax is a tax on net gratuitous receipts.

1. *Gratuitous Receipts*

An accession is a gratuitous receipt of material wealth, regardless of the mechanics of the obtaining of the receipt. Gratuitous receipts can be acquired by gift, inheritance, bequest, trust distribution, form of property ownership, beneficiary designation under contract right, and so on.

2. *Exceptions Inherent in the Concept of Accession*

The accessions tax is aimed at reaching gratuitous wealth transfers from a private individual to another private individual. If *X* performs services for *Y* at no charge, *Y* is not in receipt of an accession. Commercial transactions at arm's length do not yield accessions, even if they involve what an economist would call "transfer payments." Thus, lottery and gambling winnings, damage and insurance recoveries, rebates, and bargain purchases in commerce, would be excluded. Also excluded would be nongratuitous windfalls, such as prizes and found objects. Another group of excluded items would be transfers from institutions (including government), such as scholarships, grants, subsidies, and bounties.

Wealth transfers between related parties would be presumed not to fall within these exceptions. In the case of sales of present and future interests, the presumption would be nonrebuttable.⁸⁸ The definition of "related parties" should be broad (and flexible) enough to encompass unmarried couples.⁸⁹

3. *Relevance of Transferor's Identity*

The accessions tax focuses on the transferee, not the transferor.

a. *Transferor's Identity Generally Irrelevant*

Apart from the requirement that an accession must come from a private individual, the *identity* of the private individual is generally immaterial, unless the transferor is the spouse of the transferee or unless some special rule (such as one applicable to related parties) is conditioned on the identity of the transferor.⁹⁰

88. See *infra* text accompanying note 240.

89. For a discussion of possible definitions of "family," see Bridget J. Crawford, *The Profits and Penalties of Kinship: Conflicting Meanings of Family in Estate Tax Law*, 3 *PITT. TAX REV.* 1, 48–57 (2005).

90. Under the ALI Study, the rate of tax varies according to the degree of relationship and, therefore, the identity of the transferor would need to be determined in every case. Andrews, *Reporter's Study*, *supra* note 10, at 460.

b. Transfers to Oneself

The notion of gratuitous receipt is one in which the taxpayer receives material wealth from *another* private individual. It follows that money or property that a person receives from herself is not an accession.

In the case of receipts derived from earlier transfers (such as trust distributions), the mechanics of the exclusion for amounts that a person receives from herself (designed to measure the net gratuitous receipt) would operate in a way that is similar to the "consideration received" exception under the existing estate and gift tax (designed to measure the net gratuitous transfer).⁹¹ In the accessions tax context, the net gratuitous receipt would be the gross receipt minus the portion of the receipt attributable to the recipient herself. There are, of course, different ways in which the exclusion rules can be designed,⁹² and in this respect the accessions tax can choose to follow, or not to follow, existing estate and gift tax "consideration" rules. Nevertheless, it should be noted that in the accessions tax context the consideration issue relates only to the question of the degree to which a receipt is a gratuitous receipt from another private individual, as opposed to (under the estate tax) avoiding double taxation of the same thing to the same transferor.⁹³ This role suggests that, in a joint-transfer scenario, the recipient be taxed only on that percentage of the receipt that corresponds to the percentage of the transfer made by persons other than the recipient.

To take simple examples, if *B* purchases property (worth \$1 million) from *A* for \$1 million consideration, neither party has received an accession. Of course, if *A* and *B* are relatives or close friends, the transaction should be closely scrutinized to determine if a gratuitous receipt is being disguised as a sale on account of a deliberate over or undervaluation of the property. If *C* and *D* jointly create a trust with equal amounts, any distribution to either of them should be treated as a gratuitous receipt to the extent of 50% of the distribution. However, as will be explained later,⁹⁴ sales of present and future interests in property

91. Under the existing gift and estate tax, there is an exclusion (against transfers made) for consideration received in money or money's worth. See I.R.C. §§ 2036-2038, 2512(b).

92. Consideration-paid offsets or exclusions could operate on any of the following subtraction principles: (1) lump sum (total consideration provided), (2) lump sum augmented by interest, (3) lump sum as augmented by actual investment return, and (4) percentage contributed.

93. Under the present system, if the donor were taxed (at gift or under the estate tax) on both the transfer and the consideration received (which augments the donor's potential estate), the donor would be taxed twice on the same value. On the role of consideration under the present system, see Joseph M. Dodge, *Retentions, Receipts, Transfers, and Accumulations of Income and Income Rights: Ruminations on the Post-Byrum Role of Estate Tax Sections 2036, 2037, 2039, and 2043(a)*, 58 TEX. L. REV. 1, 51-72 (1979).

94. See discussion *infra* Part IV.D.2.

to related parties are really disguised gratuitous transfers, and would not be subject to the joint-transfer rule.

An issue is how far to take the “transfer-to-oneself” rule. Suppose Daughter makes gratuitous receipts to Parent, who eventually dies and bequeaths her estate to Daughter. Has Daughter received a transfer from herself? There are persuasive reasons not to exclude any of the Daughter’s accession. Parent (unlike a trustee) is an intervening individual who was never required to bequeath the property to Daughter. (If Parent were viewed as the mere agent of Daughter, then Parent could not be viewed as receiving an accession. But then all accessions “in” would be problematic, because such amounts might eventually be the subject of accessions “out.”) Second, in applying any such exclusion, the identity of a transferor would be crucial, and tracing through multiple transferors might be required. Finally, Daughter (in the example) could avoid the problem (if it is perceived to be a problem) by disclaiming the accession, as is explained immediately below.

4. *The Transferee’s Identity*

The identity of the transferee is implicated by disclaimers and notions of constructive receipt and vicarious enjoyment.

a. *Disclaimers*

A disclaimer is a refusal to accept a gratuitous receipt, resulting in the obtaining of the transferred wealth by another party. As under the current system, a “qualified” disclaimer would be effective to bypass the disclaimant and to shift the identity of the person(s) receiving the accession for accessions tax purposes from the disclaimant to the disclaimees. Under an accessions tax, a disclaimer could not trigger generation-skipping tax, because such a tax would not exist.

Since the accessions tax is concerned with actual gratuitous receipts, the concept of constructive receipt and retransfer is not relevant.⁹⁵ (This conclusion is supported by income tax doctrine: the constructive receipt doctrine deals with the timing issue of the year of inclusion,⁹⁶ but a disclaimer is effective to avoid income.⁹⁷) It follows that the core qualification requirement would be a refusal to accept the accession at the time it is deemed to occur, namely, upon actual receipt (or earlier). No reason would exist for tying disclaimer qualification mechanics to the law of estate administration. Disclaimers would not have to be made at

95. The same rationale explains why obtaining a general inter vivos power of appointment over property would not be an accession.

96. See Treas. Reg. § 1.451-2 (1999). The doctrine only applies to cash-method taxpayers.

97. See *Comm’r v. Giannini*, 129 F.2d 638, 641 (9th Cir. 1942) (holding that a disclaimer of salary, with no direction as to its disposition, avoided gross income inclusion); *Turner v. Comm’r*, 13 T.C.M. (CCH) 462 (1954) (determining value of includible prize with reference to “traded down” item).

the time of acquiring present and future interests, but only with reference to the time of actual receipt.⁹⁸

The only difficult issue is whether a “directed” disclaimer (to a designated person, as opposed to the persons who would take by operation of law) should qualify. This is a judgment call, as designating the substitute taker involves the exercise of only one aspect of the bundle of rights constituting fee ownership. It is true that, under the income tax, it is possible that certain disclaimers of income rights might be treated as ineffective to shift income to third-party donees.⁹⁹ However, under the income tax, the income can only be taxed to one party,¹⁰⁰ whereas an ineffective disclaimer under the accessions tax would result in the same item being a simultaneous accession to two different individuals. Double taxation of this type is unwarranted. Since the disclaimant does not actually obtain the item, and the designated person *does* obtain it, the accession should be solely that of the recipient.

b. No Vicarious Accessions

A purist might advocate the position that the transferee for accessions purposes is the person who “really” (or vicariously) benefits from a wealth transfer. Thus, if *A* owes a support obligation to *B*, and *B* receives a gift from *C* that defrays *B*’s living expenses, it is plausible to view *A* as the real transferee.¹⁰¹ However, a broad vicarious-transferee rule would raise complications for transfers to married persons and minors, and might require complex planning to avoid. Like an ineffective disclaimer, such a rule could result in the same transaction being an accession to two different taxpayers. Moreover, a vicarious consideration rule might have the undesirable effect of converting a transaction that involves the destruction of wealth into one that is treated (incorrectly) as

98. Under the current estate tax, a person receiving a present or future interest in property must effect a qualified disclaimer within a certain period of time after the interest is transferred to such person. See I.R.C. § 2518(b)(2) (2006). Such a requirement is not appropriate for an accessions tax that does not tax the acquisition of present and future interests. Since only distributions (or payments) are taxable accessions, a disclaimer should be allowed to qualify if it is either a disclaimer of a present or future interest or a disclaimer of one or more distributions or payments.

99. To generalize, nontrust gifts of the following rights are ineffective to shift income from the donor to the donees: (1) services income of the donor, *see* *Lucas v. Earl*, 281 U.S. 111, 114–15 (1930); (2) carved-out income rights (with a reversion retained by the donor), *see* *Helvering v. Horst*, 311 U.S. 112, 120 (1940); and (3) rights to accrued but unpaid income, *see* *Helvering v. Eubank*, 311 U.S. 122, 124–25 (1940). The grantor of an inter vivos trust is taxed on trust income under sections 671 through 677 on account of retained interests and powers (broadly defined). *See* I.R.C. §§ 671–677.

100. The section 102 exclusion prevents the donee from having the same income as is attributed to the donor. *See* I.R.C. § 102.

101. This problem is recognized to some degree by the current income tax, but the solutions require reattribution of income only where a support obligation is actually discharged. *See id.* § 677(b); Treas. Reg. § 1.662(a)-4 (1999). A provision to similar effect under the income tax is section 1(g), known as the “kiddie tax,” which taxes unearned income of a minor at the parent’s highest marginal rate. *See* I.R.C. § 1(g) (2006 & Supp. I 2007).

one involving the transfer of wealth.¹⁰² Such a rule would be difficult to enforce, and would entangle the IRS in the task of sorting out relationships and legal obligations. Basically, being relieved of an expense or cost is not an accession per se (although it might raise the suspicion of a concealed accession).¹⁰³ The person being relieved of a cost might find it easier to save (rather than consume), but this choice always existed.

B. ACCOUNTING FOR GROSS ACCESSIONS

The accessions tax base is aggregate lifetime net accessions (gross accessions less deductions for costs of obtaining accessions). A major aspect of figuring gross accessions is valuation, which is a huge problem area under the existing estate tax system.¹⁰⁴ Under the accessions tax, the stakes in the valuation area should be much reduced. Planning can take other avenues than valuation, such as the dispersal of wealth into zero (or low) accessions tax brackets. In addition, unlike the estate tax system, accessions can be deferred after a decedent transferor's death until liquidation in cash (or its deemed equivalent). In general, it can be said that, *like the income tax, the accessions tax avoids or finesses difficult valuation problems.*

1. When Accessions Are Deemed to Occur

A pervasive issue is when the accession is deemed to occur. The date of an accession fixes the date of valuation and triggers a person's liability to pay the tax.

The accessions tax differs from the estate tax in that it is a tax on gratuitous *receipts* of an individual. Since entities (such as trusts and estates) are not taxpayers, an accession can occur no earlier than when an *individual* receives property. An individual could be deemed to receive property either at the time of acquiring an interest therein (such as a remainder interest in a trust) or at the time of obtaining possession or enjoyment (such as receiving a trust distribution). For reasons discussed in Part IV, the better principle is that *the accession is to be deemed to occur when actually received in cash or in reasonably liquid form.* This approach is parallel (if somewhat different in content) to that of the realization requirement of the income tax. Among the important consequences of this approach is that *reliance on actuarial tables is avoided.* Also, the receipt of nonliquid assets may be cause to defer the taxable event until liquidity is obtained. Additional consequences of the

102. This point is elaborated upon in the discussion of support payments, see *infra* Part III.D.

103. This point is subject to substance versus form analysis, so that wealth transfers might not be disguised as something else. Thus, if *X* commits to paying *Y* an amount equal to *Y*'s net addition to a savings account, *Y* would have an accession. Similarly, an advance commitment by *D* to pay off *Z*'s future gambling debts could be characterized as resulting in accessions by *Z*.

104. See generally Cooper, *supra* note 15.

realization approach are spun out in Part IV. Ordinary timing and valuation issues are discussed in the material immediately below.

2. *Accession Tax Valuation Date for Estate Transfers*

A basic issue is determining when the accession occurs in the case of bequests and inheritances subject to estate administration. If there were no institution of estate administration, estate transfers would vest (and be valued) on the decedent's death, and it would not be necessary to treat the estate as a taxpayer for income tax purposes.¹⁰⁵ However, estate administration does exist, and two of its main functions are to sort out contingencies¹⁰⁶ and to determine exactly what each heir and legatee is to receive, after accounting for debts, funeral expenses, and estate transmission costs.

The optimal solution is to treat the accession as occurring upon distribution from the estate, rather than the decedent's death.¹⁰⁷ Such a principle precludes having to sort out, as of the decedent's death, contingencies and charges against accessions, avoids liquidity problems for taxpayers, and is consistent with the general timing principle of deferral until actual possession or enjoyment. If valuation were determined at death, the value thereof could be artificially reduced by unreal contingencies.

On the other hand, a blanket date-of-distribution rule might encourage undue delays in estate administration solely to reduce accessions taxes during a period of declining asset values. Therefore, I would suggest that in-kind estate transfers that are distributed after the date which is the third anniversary of the decedent's death be valued in an amount equal to the *greater* of (a) the distribution-date value, or (b) the value on the third anniversary date. This rule would exist solely for valuation purposes. The accession date itself would be the date the transferee receives the property.¹⁰⁸

3. *Contingencies Affecting the Identity of the Transferee*

A contingency that pertains only to the identity of the taker can be easily accommodated by the accessions tax: the accession would be delayed until the contingency is resolved one way or another. An

105. Instead, postdeath income and deduction items would be allocated according to the property ownership of legatees and heirs.

106. Contingencies relating to entitlement can exist due to will contests, will construction questions, heirship determinations, and the possibility of disclaimers.

107. The ALI Study omits discussion of these issues. Andrews, *Reporter's Study*, *supra* note 10. Batchelder assumes that the accession would occur at the same time as transfers occur under the existing system. Batchelder, *supra* note 10, at 19.

108. Delay in estate administration just to postpone a transferee's tax liability seems unlikely. In a rising market, delay will increase the amount of the accession. In a declining market, the transferee will object to a delay that causes the value of the property when received to be less than the accession amount.

example would be "Blackacre to *B* if she outlives me by seven years; if not, to *C*."

The foregoing assumes that no transferee is in possession (or has a right of possession) during the pendency of the contingency. A possessory interest subject to a condition subsequent would be treated the same as a nontrust life or term interest followed by a remainder.¹⁰⁹

4. *Only the Value Received Counts*

The present estate tax system is in a bind concerning valuation: although the tax is supposedly on the transferor (what the transferor had), it is said that valuation looks forward,¹¹⁰ and therefore, what the transferee obtains is highly relevant,¹¹¹ at least sometimes.¹¹² Under the accessions tax, the basic valuation norm would be clear: it is *the value of what the transferee receives as the result of a gratuitous transfer*. The value of the item in the hands of the transferor (or at the time prior to receipt) is not relevant. It follows that restrictions and rights that lapse at (or prior to) the time of the accession would be disregarded. Restrictions imposed by the transferee herself would also be disregarded.

5. *Deferred Accession of Property Subject to Valuation Contingencies*

An asset may be hard to value because of salient contingencies built into the asset itself, such as conditions of forfeiture. Unlike the estate tax system, the accessions tax can defer the accession date—past the transferor's death—until the contingency (affecting valuation) is resolved.¹¹³

It should be noted here that deferral of the accession date for the underlying property past the date of actual receipt would operate somewhat in the manner of a revocable trust under the current system: distributions from the property (whether of income or principal) during the deferral period would themselves constitute accessions to the new owner of the property.¹¹⁴

Of course, it is a judgment call as to what kinds of contingencies would cause deferral of the accession date. Certain contingencies would be considered so de minimis, latent, remote, or unforeseeable as to be

109. See *infra* text accompanying note 214.

110. See *United States v. Land*, 303 F.2d 170, 173 (5th Cir. 1962).

111. See *Goodman v. Granger*, 243 F.2d 264, 268 (3d Cir. 1957) (disregarding restriction lapsing at death); *Estate of Harrison v. Comm'r*, 52 T.C.M. (CCH) 1306, 1309 (1987) (disregarding right lapsing at death).

112. See *Estate of Curry v. Comm'r*, 706 F.2d 1424, 1430 (7th Cir. 1983) (disregarding minority interests created by bequest).

113. Deferral might also be available in difficulty-of-valuation situations not attributable to contingencies, such equity interests that are subject to minority-interest and lack-of-marketability discounts, but this issue is taken up in Part IV.E, *infra*.

114. See *Treas. Reg.* § 25.2511-2(f) (1999).

insufficient to trigger deferral. For example, a seemingly-secure patent right might be held by a court to be invalid, or the obligor on a claim may file for bankruptcy. These kinds of contingencies are factored into the value of the property determined at the accessions tax valuation date.

6. *Certain Post-Accession-Date Facts Not to Affect Value*

Although future contingencies relating to the asset itself legitimately are factored into the value thereof, future contingencies that are idiosyncratic to the person receiving the accession should not be considered in valuing the asset for accessions tax purposes. This distinction is inherent in the notion of "objective market value," and is a precondition for treating equal accessions (by different persons) of the same asset equally. For example, in the case of an accession by gift of appreciated stock, the donee should not obtain a valuation discount to reflect the higher future capital gains tax that the donee would incur relative to a person who purchases the stock on the same date.

Another example (in my opinion) of an illegitimate discount is that (allowed under the estate tax) for "blockage," which refers to the hypothetical decrease in prices caused by flooding the market with a fairly unique estate asset, such as the unsold work of a visual artist or relatively large blocs of stock in a corporation that is traded privately or over the counter.¹¹⁵ The transferee focus of an accessions tax would naturally dilute or eliminate the blockage issue for particular legatees (receiving less than the transferor's total holdings). Nevertheless, blockage discounts should not be allowed at all, because blockage assumes a certain behavior path on the part of the transferee: unloading the asset in a bloc. But artworks and shares of stock can be sold item by item or share by share. There is no reason to assume that the person receiving the accession is under a compulsion to liquidate at a price depressed by an oversupply created by the recipient herself.¹¹⁶

Disallowing a blockage discount would not be especially harsh under an accessions tax. Certain assets commonly subject to blockage discounts under current law would likely fall into the category of deferred-accession assets, discussed in Part IV, where the accession occurs (usually) on actual sale, thereby eliminating resort to hypothetical future sales. Otherwise, the discount can be obtained by liquidating the bloc prior to the estate-accession valuation date: the amount of the accession would be the actual net sale proceeds distributed.

115. See Treas. Reg. § 20.2033-2(e) (1992).

116. Minority-interest discounts are distinguishable, because the person receiving the accession never receives anything more than a minority interest.

C. THE DEDUCTION FOR COSTS OF OBTAINING ACCESSIONS

An accessions tax deduction or offset would lie for costs of obtaining accessions. Costs incurred before the accessions date to obtain or process accessions would generally be deductible for accessions tax purposes, whereas costs incurred after the accessions date would usually be accounted for only under the income tax.

1. *Costs Incurred by Estates and Trusts*

Debts of the decedent, funeral expenses, and estate administration expenses are simply paid out of the estate prior to distribution. In effect, they are paid by the decedent's stand-in, and should therefore be viewed as reducing the accessions of individuals.¹¹⁷ A similar situation exists with trusts, where distributions constitute accessions by individuals. This rule would essentially be self-executing, because it would reduce estate and trust distributions, and would avoid having to allocate costs among distributees. On the other hand, nonacquisition costs of transferees should not reduce the accessions amount. Accordingly, it might be desirable to provide for the nonsubtraction of any predistribution cost that is not a true transmission cost and that was clearly for the benefit of, and in an ascertainable amount allocable to, one or more specific transferees.¹¹⁸ However, since the tax law should not raise an artificial bar to liquidity or prudent investing, the costs of converting assets to cash, or in managing an estate or trust investment portfolio for the benefit of more than one beneficiary, would be treated as true transmission costs.

For income tax purposes (assuming that estates and trusts continue to be treated as a taxable entities), the deduction rules of current law should carry over.

2. *Costs of a Transferee in Obtaining Accessions*

Costs incurred by individuals to obtain or secure the right to an accession (such as the legal costs of a legatee to obtain a bequest) should be allowed as an offset or deduction under the accessions tax. For income tax purposes, such costs are capital expenditures that are subsumed into the transferee's "free" basis as donee, legatee, heir, etc.¹¹⁹

Nonacquisition costs of a person obtaining an accession would be accounted for only under the income tax.

117. Under the current system, debts of the decedent (other than deductions in respect of a decedent) and funeral expenses are deducted only for estate tax purposes, and estate administration expenses can be deducted either for estate or income tax purposes. See I.R.C. §§ 642(i), 691(b), 2053(a) (2006). In theory, estate administration expenses, which are paid (in an estate tax context) after the wealth transfer, should be deducted (if at all) only for income tax purposes, and funeral expenses should not be deducted at all.

118. The accession would be grossed up by such a cost, but the cost would raise a deduction issue under the income tax as if paid by the transferee.

119. See Treas. Reg. § 1.1015-4 (1975) (stating that donee's basis is the greater of section 1015 basis or cost of obtaining gift, but not the sum of the two).

3. *Encumbered Property*

In the case of encumbered property, liabilities (other than contingent liabilities) taken over by a person receiving property would be subtracted from the amount of an includible accession. These liabilities are a subcategory of "costs of obtaining accessions." Instead of being deducted when paid, they would be deducted at the time of the accession. However, if any of the deducted amount is never paid, the unpaid principal amount should be restored to the accessions tax base.¹²⁰

Contingent costs or liabilities that inhere in the asset at the time of acquisition should be treated in the same fashion as they are for income tax purposes, i.e., they should be presently ignored (instead of being deducted at their estimated value).¹²¹ If the liability later becomes absolute, the value thereof can be deducted from the accessions tax base (and any accessions tax attributable thereto can be refunded). No accessions tax deduction would arise for liabilities that arise after the accession date.

4. *State Successions Taxes*

State gift taxes paid by a donor would not be added to, nor subtracted from, the accession. Successions taxes that are paid by an estate, trust, heir, or legatee would simply be treated as an accession-acquisition cost that would reduce the net accession.

The alternative approach of conferring an accessions tax credit for state gift and successions taxes would be too difficult to manage.¹²² First, accessions would have to be grossed up by the amount of creditable taxes deemed paid by the legatee, and that would require allocating the taxes to particular accessions. Second, creditable state taxes might be paid for accessions that do not produce current federal accessions tax (or which are not yet treated as accessions for federal accessions tax purposes), and in that case the credit would either have to be refunded or else carried over.

5. *The Federal Accessions Tax*

The accession is always "before" the accessions tax itself. Stated differently, the accessions tax cannot reduce the amount of the accession. In this respect, all gratuitous receipts are treated equally, whether in the form of inter vivos gifts or otherwise.¹²³

120. Such amount is analogous to debt-discharge income under the income tax. See I.R.C. § 61(a)(12).

121. The event that causes the contingent liability to arise must have occurred before the accessions date.

122. The ALI Study raises various issues associated with a credit, and states that the whole matter should be rethought. Andrews, *Reporter's Study*, *supra* note 10, at 492-94.

123. Under the current system, the gift does not include the gift tax (if any), and gift taxes paid or owed reduce the estate tax base (unless the gift giving rise to the tax occurred within three years of

The tax is only owed by the recipient. The recipient bears the burden of the accessions tax and, generally speaking, the transferor would lack the power to directly shift the burden of the accessions tax from one transferee to another. Of course, it would be possible for the transferor to express the amount of a transfer as an after-accessions-tax amount, in which case the recipient would receive such target amount as grossed up by the amount of the transferee tax, resulting in the taxable accession being the full grossed-up amount.¹²⁴ Thus, if the transferee's marginal accessions tax rate is 40% and the transferor desires to effect a net bequest of \$100,000, the gross transfer (taxable accession amount) would be in the amount of \$167,000.¹²⁵ A transferor could similarly make a bequest of an amount (fixed dollar amount or residual estate) to multiple legatees such that the *net* accessions (after accessions tax) of each person would end up being equal, despite unequal accessions taxes. However, it seems highly unlikely that testators, under an accessions tax, would express bequests in this fashion, as it would (1) incur additional accessions taxes, (2) require the obtaining of information from third parties, (3) create additional work for the estate representative, and (4) possibly cause some grumbling among the lower-bracket legatees (who would be the losers).

D. AN ANNUAL "SUPPORT" EXCLUSION

Under the existing estate tax system, as well as the income tax, support received in kind is excluded on the grounds that (1) support does not entail a true wealth transfer, and/or (2) support payments are compelled by law.¹²⁶ Since the law of support varies from state to state (and is seldom enforced outside of the divorce context), it is best to federalize the concept of support for federal accessions tax purposes, just as it appears to have been federalized for income tax purposes.¹²⁷

I. *Payments of Another's Living Expenses*

Most support takes the form of one person paying for another's living expenses. Payments of this type are not true wealth transfers, because (a) the payor controls the spending, and (b) support entails

death). See I.R.C. § 2035(b).

124. If a donor paid a donee's accessions tax resulting from the gift, the tax would be an additional accession.

125. The formula for grossing up an after-tax amount (assuming a uniform rate) is: *Grossed-Up Amount = Net Amount / (1 - Tax Rate)*. Of course, it would be harder to figure the rate if the taxable amount straddled two or more brackets. See Rev. Rul. 75-72, 1975-1 C.B. 310.

126. See *Harris v. Comm'r*, 340 U.S. 106, 112 (1950) (transfer founded on divorce decree); Rev. Rul. 68-379, 1968-2 C.B. 414 (transfer of property not a taxable gift to the extent of the value of the support rights surrendered by the transferee).

127. See Rev. Rul. 77-282, 1977-2 C.B. 252 (defining "support," for purposes of section 152 of the Internal Revenue Code deduction for dependency exemptions, as amounts spent for the benefit of a person, regardless of state law).

current consumption (as opposed to wealth accumulation) by the recipient.¹²⁸ The rationale of the exclusion frees it from being dependent on particular relationships specified by state law.¹²⁹ The payment of any person's living expenses would qualify for the exclusion.¹³⁰

It is true that reducing a person's living costs increases their capacity to save and invest, but that is an intervening decision of the beneficiary. Nevertheless, any support exclusion must be confined within the bounds of reasonableness, and working out the details of this exclusion entails the exercise of judgment. For example, any arrangement conditioned on increased savings by the donee can be viewed as a true wealth transfer. Similarly, transfers of consumer items that are actually sold by the donee involve wealth transfers; this scenario can be taxed under the income tax (in lieu of under the accessions tax) by giving such items a zero income tax basis. Gifts of collectibles or high-end consumer products should perhaps not be excluded at all. On the other hand, "occasion" and holiday gifts that are in kind, not of an investment character, and of relatively small value, should be excluded. Cash gifts might also be excluded, but subject to an annual per-transferee limit (as the identity of the donor would be irrelevant). Distributions from trusts might even be excluded if they are "applied" for the payment of living costs while a person is clearly in a dependency mode (e.g., under the age of twenty-four, institutionalized, or disabled).

The proposed scheme would eliminate several problems with the current gift tax exclusion, such as (1) whether gifts in trust should ever be excluded, (2) whether the "present interest" requirement makes sense,¹³¹ and (3) whether a *Crummey* power really confers a present interest.¹³² Because any annual exclusion for cash gifts would be strictly a per-donee (per-year) limitation, it would not be possible for multiple donors to

128. Cf. *Carson v. Comm'r*, 71 T.C. 252 (1978), *aff'd* 641 F.2d 864 (10th Cir. 1981) (holding that a political contribution was not a gift for gift tax purposes because it carried out the donor's aims). A similar doctrine exists under the income tax: economic benefits provided by a third party are not income if they carry out the provider's aims (other than enriching the beneficiary). See *United States v. Gotcher*, 401 F.2d 118, 124 (5th Cir. 1968) (excluding value of recruiting trip provided by prospective supplier).

129. See Patricia A. Cain, *Same-Sex Couples and the Federal Tax Laws*, 1 LAW & SEXUALITY: REV. LESBIAN & GAY LEGAL ISSUES 97, 123-29 (1991).

130. The gift tax excludes paying for another's medical and education costs. See I.R.C. § 2503(e) (2006).

131. To qualify under the present gift tax, the gift must not be of a "future interest." See I.R.C. § 2503(b)(1). Since the exclusion is a per-donee exclusion under the present system, it is necessary to value the gifts received by each donee, and gifts into trust typically involve more than one donee. Under an accessions tax, a donee has an accession when receiving a trust distribution, not a trust interest. Hence, this particular problem would disappear.

132. A "*Crummey* power" is a lapsing power in a trust beneficiary to withdraw amounts added to the trust by the donor in an amount up to the annual exclusion. See *Crummey v. Comm'r*, 397 F.2d 82, 88 (9th Cir. 1968) (holding that the power created an equivalent of an outright gift to the beneficiary, even if the power is not exercised), *acq.*, Rev. Rul. 73-405, 1973-2 C.B. 321.

effect large wealth transfers to a given individual under the guise of the annual exclusion, as is possible under the current gift tax.

2. *Alimony and Child Support*

Alimony and child support are cash transfers that are likely to exceed any per-transferee exclusion. Arguably, the "compulsion" rationale should negate taxability only under a transferor-oriented wealth tax, where forced payments are akin to taxes, fines, and economic waste. Under an accessions tax, an exclusion would exist for such receipts on the different rationale that the person receiving the cash is simply taking what she is entitled to under law. Therefore, there would be no accession as the result of a "transfer," much less a "gratuitous" one.

E. ACCESSIONS FROM AND BY SPOUSES

This section discusses the unlimited "spousal exclusion" (exclusion of any accession received from a spouse) and other matters incident to spousal status.

1. *Defining the Taxable Person*

The threshold issue is whether the taxable unit for accessions tax purposes should be the married couple as a single unit or each spouse as a separate taxpayer. The income tax does treat the couple as a single unit in that (1) income and deductions are aggregated (and deemed to be allocated fifty-fifty),¹³³ and (2) intra-unit property transactions are ignored.¹³⁴ However, the single-unit approach is controversial, and many theorists would prefer an individual filing system.¹³⁵ In any event, the rationales offered for the income-tax marital-entity approach do not carry over to the accessions tax. It is fairly clear that wealth (as distinguished from consumption) is not pooled, except where compelled by law.¹³⁶ Even community property systems treat wealth acquired by gratuitous transfer as separate property of the receiving spouse. Wealth-transfer preferences favor lineages and seek to shut out in-laws and other outsiders.¹³⁷

A second rationale of aggregation, accounting convenience, makes sense for an income tax but not for a tax with a cumulative lifetime tax

133. A married couple filing jointly obtains two personal exemptions, twice the standard deduction of an unmarried individual, and a rate structure that assures non-high-income couples a tax that is no greater than twice the tax that would be paid by an unmarried taxpayer on half of the couple's aggregate taxable income. See I.R.C. §§ 1(f), 63(c)(2)(A).

134. See *id.* § 1041.

135. See, e.g., Pamela B. Gann, *Abandoning Marital Status as a Factor in Allocating Tax Burdens*, 59 TEX. L. REV. 1, 3 (1980).

136. See Marjorie E. Kornhauser, *Theory Versus Reality: The Partnership Model of Marriage in Family and Income Tax Law*, 69 TEMP. L. REV. 1413, 1425 (1996).

137. It appears that very few gratuitous transfers are made to spouses of relatives. See Mary Louise Fellows, *Wills and Trusts: "The Kingdom of the Fathers,"* 10 LAW & INEQ. 137, 156 (1991).

base and a lifetime exemption. Under a marital-unit approach, unused lifetime exemptions would need to be combined at marriage and separated out on divorce.

Thus, married persons would be considered to be separate taxpayers for purposes of the accessions tax. Therefore, each spouse has his or her own lifetime exemption, annual exclusions, and rate schedule.

2. *Qualification for the Spousal Exclusion*

Any tax benefit for transfers from one spouse to another would take the form of an exclusion from the accessions tax base, referred to herein as the "spousal exclusion."

a. *General Qualification Rules*

Under the existing estate tax system, qualification is necessary to obtain a deduction for an item that would otherwise be a taxable transfer. The deduction must be determined *ex ante* (at the time of transfer), and that necessity raises the problem of the contingent spousal interest, which has produced the notorious "terminable interest rule."¹³⁸ In addition, the present scheme is designed so that any deductible transfer of the transferor spouse must be in a form that will be included in the transferee spouse's tax base.¹³⁹ The present system has evolved to the point where qualification has become detached from the notion that the transferee spouse should own and/or control the transferred property. For example, the QTIP trust is wholly deductible by the transferor spouse (on condition that unconsumed trust property be included in the transferee spouse's tax base), despite the fact that it confers only an income right on the transferee spouse.¹⁴⁰

The problem of *ex ante* qualification disappears under the accessions tax, because an accession only occurs when cash or property is actually received in fee. The acquisition by gratuitous transfer of income interests and remainders is ignored. Thus, if *X* (the first spouse to die) creates a trust, income to surviving spouse *Y* for life, remainder to *C*, the creation

138. A terminable interest is an interest in the surviving spouse that *might* (as of the date of transfer) fail or lapse on account of any contingency (even if the contingency never occurs). See Treas. Reg. § 20.2056(b)-1(c)(1)(ii) (1994). A terminable interest is disqualified if (on such hypothetical failure or lapse) the property *would* pass to any person other than the transferee spouse (or her estate). See I.R.C. §§ 2056(b)(1), 2523(b). Examples include: (1) *H* to *W* if *W* outlives *H* by one year (even if *W* in fact outlives *H* by one year); and (2) *H* to *W* for life, remainder to *C*.

139. Qualifying deductible transfers (including those under statutory exceptions to the terminable interest rule) must be in a form that causes inclusion in the cumulative tax base of the transferee spouse if the property is not consumed. See I.R.C. §§ 2033, 2041(a)(2), 2044, 2511(a), 2514(b), 2519.

140. See I.R.C. §§ 2044, 2056(b)(7), 2519, 2523(f). Even worse in this respect is the "estate trust," described *infra* note 143. For critiques of the QTIP and estate trusts, see Joseph M. Dodge, *A Feminist Perspective on the QTIP Trust and the Unlimited Marital Deduction*, 76 N.C. L. REV. 1729, 1730 (1998), arguing against the unlimited marital deduction and QTIP qualification rules of the current system, and Wendy C. Gerzog, *The Marital Deduction QTIP Provisions: Illogical and Degrading to Women*, 5 UCLA WOMEN'S L.J. 301 (1995).

of the trust does not produce any taxable accession to any person, but income distributions to *Y* would be excluded, and the termination distribution to *C* would be included. The outcome is the same for a trust created by *X*, income to or among a group consisting of *Y* and the descendants of *X*: distributions to *Y* would be excluded, and distributions to other persons would not. For transfers that are contingent (say, on *Y*'s survival for a certain period), any transfer that ultimately is reduced to *Y*'s possession would be excluded.¹⁴¹ In sum, the accessions tax basically follows a wait-and-see approach to qualification. The wait-and-see approach could not be avoided either by giving the transferee spouse a general power of appointment¹⁴² or by the creation of an "estate trust."¹⁴³

The only serious qualification requirement, then, would be that the accession be "from" a person who was the taxpayer's spouse when such person died or made the transfer. Also, the exclusion would be denied in cases where the accession was illusory, i.e., the surviving spouse could not spend or dispose of the accession property as she sees fit.¹⁴⁴

b. Qualification Where One Spouse Is a Nonresident Alien

The marital deduction under the current estate tax is a deferral scheme: deduction is contingent on inclusion in the tax base of the transferee spouse.¹⁴⁵ Thus, there is a provision designed to avoid a situation where a U.S. decedent spouse obtains a marital deduction for a transfer that avoids estate tax to a nonresident-alien surviving spouse.¹⁴⁶ This scenario would not be of particular concern under an accessions tax, as there would be no marital deduction, and *the marital exclusion would not be tied to any condition of prior or subsequent accessions taxation*. Thus, no reason would exist for denying the spousal exclusion in either

141. The accessions tax wait-and-see approach would not be short circuited by giving the transferee spouse a general power of appointment or by creating an "estate trust" (a trust in which no distribution can be made to a person other than the transferor's spouse or the estate of such spouse).

142. See *infra* text accompanying note 198.

143. An "estate trust" is a trust in which no distribution can be made to a person other than the transferor's spouse during such spouse's lifetime, and on such spouse's death the trust assets are payable to the spouse's estate. See Treas. Reg. §§ 20.2056(b)-1(c)(1), 20.2056(c)-2(b)(1) (1994). Such a trust fully qualifies for the marital deduction in full under current law, even though the surviving spouse receives no distributions. See *id.* § 20.2056(b)-1(g) ex. 8. Under the accessions tax, only distributions to the spouse when living (directly or indirectly) would be excluded. The distribution to the spouse's estate would augment accessions received by third parties. For a fuller discussion of "estate" remainder interests, see *infra* text accompanying note 205.

144. The estate tax equivalent of this rule is found in section 2056(b)(4)(B), which denies marital deduction for property subject to encumbrances and obligations. See I.R.C. § 2056(b)(4)(B). Property received by a surviving spouse subject to a liability would count as a potentially taxable accession only to the extent of the net equity acquired in the property.

145. The qualification rules of sections 2056 and 2523 are such that the property will be included in the transferee spouse's tax base under one or more of sections 2033, 2041(b)(2), 2044, 2511, and 2519. See I.R.C. §§ 2033, 2041(b)(2), 2044, 2056, 2511, 2519, 2523.

146. See I.R.C. § 2056A (stating that qualified domestic trust qualifies for the marital deduction on condition that it be taxed no later than death of nonresident-alien surviving spouse).

“inbound” or “outbound” accession situations, despite the possibility that the money or property constituting the accession might “permanently” avoid U.S. accessions tax by eventual retransfer to foreign persons.

c. *Planning and Drafting Implications of Qualification Rules*

In contrast to the current system, which “channels” marital transfers of wealthy spouses into various rigid forms, such as the QTIP trust, the accessions tax would be “neutral” across numerous planning and drafting options: trust versus nontrust transfers, the number of trusts, the existence and identity of nonspouse beneficiaries, conditions precedent or subsequent, powers conferred on the transferee spouse, and powers of trustees (and third parties). Indeed, the accessions tax would be relatively neutral towards marriage itself, because deferral, exemptions, and exclusions can all be obtained without regard to the spousal exclusion.

3. *Scope of the Marital Exclusion*

The issue here is whether the spousal exclusion should be limited in some fashion. The conclusion is that a limitation is impractical.

a. *Rationale of the Exclusion*

An initial query might be whether there should be any marital exclusion at all, over and above the lifetime exemptions of each spouse. Since the purpose of the accessions tax is to curb undue concentrations of unearned wealth, it would appear that any spousal exclusion over and above a person’s lifetime exemption would confer an unwarranted advantage to a person simply by reason of marriage.¹⁴⁷

It cannot be assumed, however, that spousal accessions are of unearned wealth. Earned wealth of a person should always avoid the accessions tax. A common attitude is to view marriage as a kind of economic partnership, so that the marital estate is akin to an entity in which each spouse has equal distribution and liquidation rights, at least in principle. The partnership theory is embodied in community property systems, and common law systems have strong partnership-theory features, such as equitable distribution upon divorce, spousal elections against the will, and possibly alimony rights. Although the partnership theory is flawed as an empirical generalization,¹⁴⁸ it expresses a deep cultural norm that usually operates to benefit married women. In the present context, the main implication of the partnership theory of marriage is that the property-poor spouse “earns” the right to half of the

147. For an argument for no marital deduction (combined with a very large exemption) under the current estate tax system, see Bridget J. Crawford, *One Flesh, Two Taxpayers: A New Approach to Marriage and Wealth Transfer Taxation*, 6 FLA. TAX REV. 757, 797-99 (2004).

148. See Gann, *supra* note 135.

aggregate marital estate. As previously noted in connection with the discussion of child support and alimony, simply taking what is "yours" is not an accession. At the same time, the partnership theory of marriage would seem to posit an implied limitation on the spousal exclusion: tax-free marital transfers should not convert the poorer spouse into the richer spouse (which, technically, amounts to an aggregate-estate-equalization limitation).¹⁴⁹

b. Spousal Gifts

It is certain that Congress would not impose any limitation on interspousal transfers during the period that both spouses are alive, just as such transfers are ignored under the income tax.¹⁵⁰ Policing interspousal transfers during the term of the marriage would be very difficult, and attempts to do so would be considered an invasion of marital privacy. Also, it is highly unlikely that the wealthier spouse would voluntarily make such large spousal gifts as to shift the balance of wealth to the poorer spouse.

c. Accessions by Reason of the Death of One's Spouse

Similar considerations militate against imposing an estate-equalization limitation upon the death of a spouse. Such a limitation would require valuation of the aggregate marital estate and a determination of which spouse owned what. Moreover, it is quite unlikely that the estate-equalization norm would be violated in practice, because of wealth owners' desire to keep wealth away from successor spouses and in-laws,¹⁵¹ combined with the fact that only actual outright accessions (cash and in-kind fee simple ownership) would qualify for the exclusion.

Thus, it is inevitable that any accessions tax spousal exclusion would be unlimited.¹⁵²

149. The operation of the aggregate-estate-equalization limitation can be illustrated by assuming an aggregate marital estate of \$10 million, of which \$6 million is owned by X and \$4 million by Y: either X or Y can withdraw \$5 million tax free. That is, Y could receive \$1 million of accessions from X tax free, but X could not receive any tax-free accessions from X. Estate equalization clauses of this general aim have been used under the current estate tax. See *Estate of Smith v. Comm'r*, 66 T.C. 415, 425 (1976), *aff'd per curiam*, 565 F.2d 455 (7th Cir. 1977) (allowing formula estate-equalization marital bequest to qualify for the estate tax marital deduction).

150. See I.R.C. § 1041. Spouses are considered alter egos of each other under the grantor trust rules. See *id.* § 672(e).

151. Under the existing estate tax, the qualification rules create a huge potential gap between the marital deduction amount and what the transferee spouse actually reduces to possession or enjoyment. See *supra* notes 140, 142-43 and accompanying text. This discrepancy would disappear under the accessions tax; QTIP trusts and estate trusts would serve no tax purpose.

152. Under the estate and gift tax marital deductions, various limitations imposed under prior law have, since 1981, given way to an unlimited marital deduction. See H. REP. NO. 97-201, at 158-64 (1981).

4. *Definition of "Marriage" and "Spouse"*

The existence of a spousal exclusion applies pressure to the definition of "spouse" for accessions tax purposes. The theory that supports the marital exclusion (that the property is "theirs" under a partnership theory) also supports a functional definition of marriage that is not limited to state law marriage but includes marriage-partnership equivalents (as distinguished from mere convenience-serving cohabitation arrangements). However, since the accessions tax advantage of marital transfers is not insignificant, it would be necessary to limit marital status to situations that are formalized and not susceptible to casual or whimsical alteration.¹⁵³

5. *Accession by a Married Person from a Third Party*

The knee-jerk reaction for gratuitous accessions by a married person from a third party would be to allow fifty-fifty "accession splitting," following the model of the present gift tax, which allows fifty-fifty gift splitting for gifts by a married person to third parties.¹⁵⁴ However, accessions "into" a marriage do not have to be treated the same as gifts "out" of the marriage. Accessions "in" are not limited to inter vivos gifts, but would include all gratuitous receipts. The current gift-splitting rule exists for two reasons. One is that such a rule achieves parity with married couples in community property states. However, gratuitous *receipts* are usually considered to be the separate property of the recipient, not community property. The second reason for the current gift-splitting rule is that the wealthier spouse who is the donor could have given the poorer spouse a tax-free gift (under the gift tax marital deduction) in advance of each spouse giving an equal amount to the outside donee. Thus, the end result may as well be viewed as if this intermediate step had been undertaken. However, in the case of the accessions tax, treating a gift "in" as having been received fifty-fifty is not compatible with the end result in most cases, because it cannot be assumed that such an accession would be shared fifty-fifty with the other spouse, and a person shouldn't be charged with an accession that she doesn't actually receive. Of course, the accession *can* be shared with the other spouse, and in that case the gift by the donee spouse over to the other spouse would be an excluded accession to the other spouse.

A concern is to prevent the transferor from allocating the gratuitous transfer between the spouses in a way that minimizes accession taxes. The fact that gratuitous transfers are rarely made to in-laws would raise doubts whether the designated recipient in a given case is really the recipient in substance. This concern would be heightened in the case of inter vivos gifts of cash and nonregistered property, where actual

153. See Cain, *supra* note 129, at 105-09 (formal contracts).

154. See I.R.C. § 2513.

enjoyment would be hard to ascertain. It would be best to reject not only a fifty-fifty rule but also a rule that would allow an accession to be split between the spouses in whatever portion the transferor or the spouses themselves decide pursuant to a tax election.

The basic approach should be that substance matters. Thus, in the case of registered property, the donee designation should be determinative, unless the IRS can prove that it lacks substance. For nonregistered property, the rebuttable presumption should be that a gratuitous receipt is to be attributed entirely to whichever spouse is (more closely) related to the transferor.

IV. TIMING (DEFERRAL) ISSUES

The fact that the accessions tax is a tax on transferees has profound implications for issues that confound the current estate tax, which mostly cluster around issues of timing and valuation. The current transfer tax system requires all relevant facts (including values) to be determined as of the date of transfer (usually, the decedent's death). *Under an accessions tax, the system can be designed so that the accession is deemed to occur when it can be accurately valued, which is usually the time amounts are received as cash (or in reasonably liquid form).* An accession resulting from a bequest (or other transfer at death) can, under appropriate circumstances, be deemed to occur at a time *after* the transferor's death.

A. REALIZATION OF ACCESSIONS

The accessions tax, being (like the income tax) a tax on receipts, can and should adopt a realization concept that would defer taxable events, in certain cases, to times when accessions can be accurately valued and are liquid.

I. Adapting the Realization Principle to the Accession Tax

An accession is a form of income that would, under the accessions tax, be taxed under a different rate and exemption structure. The income tax is permeated by the realization principle, which is founded on considerations of liquidity, accurate valuation, and finality. The salient realization rules of the income tax are the cash method of accounting,¹⁵⁵ the nonreckoning of asset gains and losses until sale or disposition,¹⁵⁶ and the deferred taxation of contingent rights. Although academics tend to trash the realization principle,¹⁵⁷ it appears to be a remarkably stable

155. See I.R.C. § 446(a), (c). Under the cash method of accounting, used by virtually all individuals, rights, and obligations to receive or pay cash in the future are not included or deducted; only the future cash receipt or payment is included or deducted. See Treas. Reg. § 1.451-1(a) (1999).

156. See I.R.C. § 1001(a).

157. The Haig-Simons concept of income, as advanced in HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 205-24 (5th ed. 1965), and

feature of the income tax that not only refuses to go away but might even be making somewhat of a comeback.¹⁵⁸ Its permanence in the income tax can perhaps be explained by (a) the conformity of the realization principle to the ability-to-pay fairness norm,¹⁵⁹ and (b) an abhorrence of valuation for practical reasons.

The case for a realization principle is even stronger in the accessions tax than under the income tax. First, the liquidity problem is likely to be real: because a taxable accession in kind may be worth many times the recipient's annual income, the taxpayer could truly be in a liquidity bind. Second, the need for accurate valuation is greater under the accessions tax than the income tax, because the accessions tax has one chance to "get it right," whereas the income tax contains a mechanism (basis and subsequent realization) that allows valuation errors to be eventually corrected.¹⁶⁰ Third, since fairness in taxation entails comparisons of similarly (or dissimilarly) placed individuals, accuracy in tax base measurement is essential. Accuracy is obtainable by measuring economic outcomes. Statistics and estimates (that may be reliable for entire populations) subvert fairness.

In the context of an accessions tax, it is a judgment call as to how far to push the realization concept.¹⁶¹ Deferred realization for all in-kind property receipts would increase the opportunity for tax avoidance, because it would be necessary to "track" deferred-realization assets.¹⁶² Identification of such assets among the mass of assets that are sold would be extremely difficult for the IRS.¹⁶³ Taxpayers would have no general expectation of a general deferred-realization rule: income of the type

adopted as an income tax norm in numerous writings, *see, e.g.*, RICHARD GOODE, *THE INDIVIDUAL INCOME TAX* 13-14 (rev. ed. 1976); David A. Weisbach, *A Partial Mark-to-Market Tax System*, 53 *TAX L. REV.* 95, 95-96 (1999), would reckon annual changes in asset values into the tax base. A seminal article advanced a cash flow consumption tax over the income tax principally on the basis of defects in the realization principle. *See* William D. Andrews, *A Consumption-Type or Cash-Flow Personal Income Tax*, 87 *HARV. L. REV.* 1113, 1164-65 (1974). Ironically, a cash-flow consumption tax can be characterized as an income tax that pushes realization to the ultimate degree, with only receipts of cash (plus the value of consumer goods) being included in the tax base.

158. *See* Bryan T. Camp, *The Play's the Thing: A Theory of Taxing Virtual Worlds*, 59 *HASTINGS L.J.* 1, 25-43 (2007) (grounding realization principle in social values and need to accurately value in-kind income).

159. *See* Deborah H. Schenk, *A Positive Account of the Realization Rule*, 57 *TAX L. REV.* 355, 377-82 (2004).

160. In the income tax, if a hard-to-value asset is included in income, the included amount creates a basis equal to the amount included, and, if the taxpayer overvalues the asset on receipt for inclusion purposes, the taxpayer's basis will exceed its value on receipt, creating a potential loss deduction for the taxpayer.

161. *See, e.g.*, Pareja, *supra* note 7, at 875-96 (advancing a general deferred-realization rule in the context of an income-inclusion system).

162. Essentially, a deferred-realization asset would have a "zero basis" for accessions tax purposes.

163. *See* Joseph M. Dodge & Jay A. Soled, *Debunking the Basis Myth Under the Income Tax*, 81 *IND. L.J.* 539, 556-60 (2006).

that is commonly received in kind (compensation, prizes) is generally realized upon receipt.

Thus, assets that are liquid and can be readily valued (such as publicly-traded securities and includible consumer items) would generally be treated as accessions upon receipt. The discussion of what assets would be subject to a deferred-realization rule is found in section E of this Part.

Deferred realization under an accessions tax means that the *accession itself* is deferred (as opposed to the *tax* being deferred). The taxpayer receiving the accession is identified at the time of deferred realization, not the earlier time when the property right or interest is transferred or acquired. Thus, if qualified nonliquid (deferred-realization) asset *X* is bequeathed from *A* to *B*, and several years later is the subject of a gift from *B* to *C*, who later sells the asset, then deferral means that any investment return to *B* and *C* will be treated as accessions of *B* and *C* respectively, but the sales proceeds would be an accession entirely to *C*.

2. *Who Is Afraid of Deferral?*

The government is not a systematic loser in cases of deferred realization under the accessions tax. The value of property is the sum of future returns (income and principal) reduced to present value. If the property as a whole produces an economic return equal to the discount rate used in valuing it, taxing property now is the equivalent (in present value terms) of taxing the entire yield later, and vice versa, assuming a flat tax rate and no exemptions. Under the accessions tax in cases of deferred realization, all future yield (income and return of capital) will appear in the accessions tax bases of one or more persons.¹⁶⁴

Deferral is a problem under the income tax, but not the accessions tax, because the structures of the two taxes differ. Under the income tax, the norm is that investments should be “after tax” (made with previously-taxed dollars).¹⁶⁵ The invested after-tax dollar amount creates “basis” that is subtracted from net returns to produce “income” that is taxed when realized. Since the after-tax cost of the investment represents the present value of all future net returns (principal and income), the result can be (and often is) characterized as “double taxation of income” to the same person.¹⁶⁶ Since many investments are inevitably double-

164. The ALI Study makes all of these points, but then goes on to propose a special “estate tax” for large trusts. Andrews, *Reporter’s Study*, *supra* note 10, at 512–21.

165. Cash investments are after tax because the cash (presumably) comes from income that is taxed (like salary), and the investment maintains its after-tax status by reason of being a nondeductible capital expenditure. See I.R.C. § 263(a) (2006).

166. Double taxation does not occur in real time, but only as a result of the analytical construct that views the tax treatment of the investment as constituting an “advance” taxation of the “income” portion of the future return.

taxed in the sense just described,¹⁶⁷ economic efficiency mandates that all investments be double-taxed. Failure to tax trust income as it accumulates within the trust would be an anomaly, and that is why it is necessary to treat trusts (and estates) as taxpayers under the income tax.¹⁶⁸

Under the accessions tax, there is no norm (or necessity) of double taxation of accessions to the same person within the accessions tax. It would be bizarre to treat a legacy of corporate stock as an accession, and then to treat the dividends on the stock as a further accession to the same person. Since "single taxation" is the norm within the accessions tax, taxing the future returns (income and principal) as accessions only when received (realized) is the *same* (in present-value terms) as taxing the property itself when received. Thus, there is no "necessary" loss to the system by deferring accessions tax until realization (assuming a flat tax rate with no exemptions). The only advantage to taxpayers and government would derive from the rate and exemption structure, but that structure can cut both ways. Thus, deferral *in the case of a given taxpayer* is likely to increase the tax (because the larger tax base will climb up the rate brackets), but deferral may also create opportunities to save taxes through multiplication of distributees (each with her own exemptions and lower brackets). However, this form of tax avoidance is actually to be desired, given that the accessions tax system is designed not only to raise revenue, but to curb undue accumulations of wealth by encouraging dispersal.

*The bitter enemy of a wealth transfer tax is acceleration of the taxable event to the earliest possible date.*¹⁶⁹ The classic example is a gift of a remainder interest with retention of the income interest by the donor for life.¹⁷⁰ In the absence of a provision that postpones the transfer to the date of the donor's death,¹⁷¹ the effect of such a transfer would be to minimize the taxable amount, and reduced taxable amounts fit more easily into the lifetime exemptions and lower rate brackets that are characteristic of wealth transfer taxes.

167. Investments made with included income, such as salary, business income, and non-excluded investment income, are said to be "after tax," whereas investments made with excluded income (including borrowed money) or which are currently deductible in full are said to be "before tax."

168. See I.R.C. § 641(a). Trusts and estates are taxed on accumulated (nondistributed) income. Distributed income is taxed to the distributees. See *id.* §§ 652, 662.

169. Curiously, the ALI Study would allow an income beneficiary to accelerate accessions tax on the basis of the actuarial value of the income interest. Andrews, *Reporter's Study*, *supra* note 10, at 500-01.

170. This scenario is discussed more fully below. See *infra* Part IV.E.

171. This transfer is included in the transferor's gross estate under section 2036(a)(1). See I.R.C. § 2036(a)(1).

B. TRUSTS

The paradigm deferral scenario is, of course, the trust, which is a bundle of beneficial interests that are, at best, capable of valuation only under actuarial tables and, at worst, are contingent. There is virtually no market for even vested trust interests, and market values are heavily discounted from actuarial values because potential buyers are at a systematic information disadvantage. “Unitary taxation” (of the trust as a whole) is not an option, because the trust is not a separate taxpayer for accessions tax purposes. *Beneficiaries are taxed only upon distribution, not the acquisition of an interest (or of general power of appointment over the property)*. This system is not only extremely simple, but is apparently immune from the kinds of abuses that plague the present system.

1. *The Trust Is Not a Taxpayer*

If the trust were a taxpayer having accessions for transfers into trust, then (as previously noted) subsequent distributions to beneficiaries could not be accessions, because then the accessions tax would internally impose double tax. If trusts were treated as separate taxpayers, then what would the rate and exemption structure look like? Initially, a trust should have no exemption, because a transferor should not be allowed to create exemptions at will by creating trusts. If trusts were to possess exemptions (either singly or on a consolidated basis), then trust transfers would be tax advantaged relative to outright transfers. But, if there were no trust exemption, then the beneficiaries as a group would be taxed regardless of their individual exemption situations and rate-bracket locations. Thus, trusts would then be *disadvantaged* relative to outright bequests. In sum, trusts can not be neutered.

Another reason not to treat trusts as taxpayers is that it would defeat a principal collateral benefit of the deferral approach, which is the avoidance of qualification rules (as will be explained in due course). If accessions by trusts are potentially taxable, then it would be necessary to determine what interests in trusts might be excluded as qualifying marital interests, qualifying charitable interests, and interests qualifying under the annual exclusion. Qualification rules tend to channel gratuitous transfers into forms that a transferor might not otherwise choose. Not only does qualification need to be determined *ex ante*, but the qualifying interests would have to be valued using actuarial tables.

2. *How Beneficiaries Would Be Taxed*

Under the accessions tax, the taxable accession event(s) for a trust beneficiary would be the receiving of a distribution in cash or in kind, *whether the distribution is of principal or income*. The gratuitous receipt of a present or future interest in trust property (or the vesting of, or control over, any such interest) would not be considered to be an

accession.¹⁷² Hence, actuarial tables would not be used. *Interests that qualified for favorable treatment (marital, charitable interests, etc.) would not have to be identified (and valued) in advance, because the qualified distributions would simply be exempt from accessions tax.*

Under a system in which only distributions count as accessions, no purpose would be served by rules like the grantor-trust rules of the income tax,¹⁷³ or the "string" rules of the gift and estate tax¹⁷⁴ for determining the time that an inter vivos transfer is deemed to be complete. All transfers "in" would be treated as being incomplete, and only distributions "out" would constitute accessions. Thus, the trust transfer would be held open even after a transferor's death.

A distributee who created and funded the trust would, of course, exclude any distribution to her from her accessions tax base. If a person was the transferor of a portion of the trust assets, a distribution to such person should be excluded to the extent of that fraction thereof as the contribution supplied by the person bore to the entire value of the trust at the time of contribution.¹⁷⁵

Costs of trust administration, losses, and other costs (such as income taxes on the trust and state generation-skipping taxes) would simply reduce (sooner or later) the net accessions of beneficiaries.

3. *Distributions as Both Accessions and Gross Income*

The deferral approach produces a result in which a trust distribution that is gross income to a person under the rules of Subchapter J of the income tax would also be an accession to the same person.¹⁷⁶ The initial issue is whether such double taxation is legitimate. From "inside" the accessions tax, such double taxation is a necessary corollary of the deferral scheme for trusts. If the accessions tax were payable ex ante, the amount subject to accessions tax would be the present value of all future returns, whether income or principal (corpus).¹⁷⁷ If the accessions tax is

172. Actuarial tables would not have to be used in the situation where one person holds all beneficial interests in a trust, because in that case the person could be treated as acceding to a fee simple absolute. However, if an exception to the general deferral rule for trusts were to lie for such a case, then qualification rules would need to be put in place. Creating an exception to the general rule would serve no apparent purpose, and, since it would operate favorably to the government, would discourage this type of trust to no policy purpose.

173. I.R.C. §§ 671-677.

174. *Id.* §§ 2035(a), 2036-2040.

175. To be treated as "consideration" the contribution must be an addition to the earnings base. Repairs and maintenance costs would not qualify.

176. Under Subchapter J, the net income of the trust (computed under income tax principles) is taxed either to the trust or the beneficiaries. See I.R.C. § 102(b) (computation of gross income includes income from gifted property); *id.* § 641(a)-(b) (income from any kind of property is taxable). Distributions are deductible to the trust to the extent of "distributable net income" (modified trust net income). *Id.* §§ 651(b), 661(a). Distributions are includible by beneficiaries to the extent that they are deductible to the trust as distribution deductions. *Id.* §§ 652(a), 662(a).

177. The analogy is to the wage tax versus the consumption tax. Under the consumption tax the

deferred but only corpus distributions are taxed, then the accessions tax base would be significantly reduced in present-value terms, and deferral through a trust would systematically short-change the government.

From an overall perspective, double income/accessions taxation is the necessary consequence of a wealth transfer tax that is separate from an income tax. An income tax (conceptually) reduces wealth as it is acquired. A wealth transfer tax imposes a tax on (after tax) wealth as it is gratuitously transferred or received. In the absence of the realization principle under the income tax (that defers income taxation in various situations), the income tax would always be imposed first (on the transferor), and the wealth transfer tax would be imposed subsequently (on the transferee). However, the realization principle under the income tax can sometimes defer realization past the death of the income earner, and this has posed problems of income tax design. In the case of deferred wages (and other earned, but unpaid, ordinary income), the income is included by the decedent's successor in interest when realized, even though the right to such income is also included in the decedent's gross estate.¹⁷⁸ Thus, near-simultaneous double taxation can occur under the existing system. But, for reasons that might charitably be termed "historical," unrealized appreciation in assets includible in a person's gross estate for estate tax purposes is never taxed to anybody under the income tax.¹⁷⁹ In recent times, the only argument that attempts to justify exempting unrealized appreciation (at death) from income tax is that simultaneous double taxation would be inconvenient.¹⁸⁰ "Inconvenience" is not a principled argument, however. One tax benefit (deferred realization) does not warrant another benefit (permanent exemption).

In the accessions tax context, the same inconvenience argument might be made against double taxation of income distributions under the income and accessions taxes. However, the inconvenience argument is

investment is before tax, but the entire economic return (income and principal) is taxed; under the wage tax, the investment is taxed, but the entire return is exempt from tax. ACKERMAN & ALSTOTT, *supra* note 36, at 243 n.15. The two approaches are economic equivalents (assuming flat tax rates). To illustrate this point in the context of a consumption tax, assume that a trust is created with \$1 million that obtains a 5% gross rate of return, the income tax rate is 30%, and the accessions tax rate is 40%. If the accessions tax is paid ex ante, the \$1 million is reduced to \$600,000, the income on which is \$30,000 (after one year), producing an income tax of \$9,000, leaving \$21,000 of income after tax. This is the same result as not imposing the accessions tax ex ante and taxing the income under both the accessions and income taxes.

178. I.R.C. § 691(a). This category of income is called "income in respect of a decedent" (IRD).

179. Neither death nor the transfer is considered a realization event (and the actual amount realized is zero). The decedent's successor obtains a basis equal to the asset's fair market value at death. *Id.* § 1014(a)(2). Section 1014 appears to be based on the trust accounting concept of income: gratuitous transfers into trust are principal and not income.

180. See Ronald D. Aucutt, *Further Observations on Transfer Tax Restructuring: A Practitioner's Perspective*, 42 TAX LAW. 343, 347 (1989). However, a wealth transfer tax is a separate tax from the income tax.

overstated (as well as being unprincipled). First, the double taxation is not necessarily assessed to the same person at the same time. Current trust income is either accumulated or distributed. If it is accumulated, it is currently subject to income tax to the trust, as a taxable entity, and the trust is liable for the tax. When distributed in the future, such accumulated income will constitute an accession, but not income, to the individual distributee.¹⁸¹ It is only in cases where current trust income is currently distributed that such distribution is both an accession and income to the same person at the same time. From a planning perspective, simultaneous income and accessions tax to the same person can be avoided by accumulating income and net capital gains for distribution in future years. Second, even in the case of simultaneous taxation to the same person, the income tax burden might be reduced by manipulating the rules of Subchapter J.¹⁸² Third, the burden of any simultaneous double taxation is reduced on account of the fact that the first tax reduces the tax base of the second tax. In the usual gratuitous-transfer scenario, the income tax paid or owed would simply reduce the accessions tax base. However, under the current system, where the estate tax is imposed first, the estate tax attributable to the future income right is subtracted from the income tax base.¹⁸³ In the simultaneous income/accessions tax scenario, it would be necessary to create a rule that provides for which tax is to be deemed paid "first" so as to be subtracted from the tax base of the other tax.¹⁸⁴ I would slightly favor

181. Distributions to beneficiaries are income to beneficiaries only to the extent of *current* (modified) trust net income. See *supra* note 176. Effectively, distributions of accumulated income are treated as non-income (previously-taxed) corpus distributions.

182. Distributees are taxed essentially on the lesser of current-year distributions or current-year trust net ordinary income. See *supra* note 176. Thus, trust net ordinary income might be reduced by various stratagems, such as by investing in assets that provide return in the form of unrealized appreciation or capital gains. In addition, the character of the trust net income passes through to the distributee. I.R.C. §§ 652(b), 662(b).

183. See I.R.C. §§ 691, 1015(d)(6) (allowing the estate or gift tax attributable to the yet-to-be-taxed income or gain to reduce the income tax base where estate or gift tax is imposed before the income tax on income in respect of a decedent or unrealized appreciation in gift property). Arguably, these provisions are misconceived, because they are paired with rules that shift income from a decedent or donor to such person's successor, so that the successor's income tax on these items will reduce the successor's own transfer tax base. See *id.* §§ 691(a), 1015(a). The estate or gift tax will reduce the income tax base of the collective successors in interest. Thus, the same estate or gift tax is operating both as an exclusion and a deduction of the successor. Transfer taxes are not generally allowed as income tax deductions of successors. See generally IRS, U.S. DEP'T OF TREASURY, PUBL'N No. 950, INTRODUCTION TO ESTATE AND GIFT TAXES (2008), available at <http://www.irs.gov/pub/irs-pdf/p950.pdf>.

184. Consistency with the income-tax-first scenario suggests deducting the income tax from the accessions tax base. However, it actually makes no difference to the distributee as to which tax is deducted from the other tax base. Assume that a trust created with \$1 million obtains a 5% gross rate of return, that the income tax rate is 30%, and that the accessions tax rate is 40%. If the accessions tax is deducted against the income tax, the before-tax distributed income yield of \$50,000 generates an accessions tax of \$20,000, net income of \$30,000, and an income tax of \$9,000, leaving \$21,000 after tax. If the income tax is deducted against the accessions tax base, the distribution of \$50,000 would produce

treating the income tax as having been imposed first.¹⁸⁵ The income tax on the income distributee is similar to other deductible (or subtracted) costs of obtaining accessions, such as estate and trust income taxes and estate and trust administration expenses.

4. *Alternative Systems of Trust Taxation?*

Prior advocates of an accessions tax have hesitated over the deferral issue,¹⁸⁶ proposing a withholding/credit system for transfers to large trusts.¹⁸⁷ As already noted, deferral is not really a problem,¹⁸⁸ and a withholding/credit system is a bad idea. First of all, schemes of this sort are necessarily complex.¹⁸⁹ Second, such schemes are pointless from the government's point of view¹⁹⁰ if they provide that distributees can earn interest (or its equivalent) on withheld amounts.¹⁹¹ Third, there is no clear or even principled method of allocating the withholding tax to particular distributions as they occur over time.¹⁹² Fourth, further

an income tax of \$15,000, a net accession of \$35,000, and an accessions tax of \$14,000, again leaving \$21,000 after tax. Thus, there is no reason in theory to prefer one approach over the other.

185. If the income tax is treated as occurring first, it would reduce not only current accessions but also the cumulative accessions tax base. If the accessions tax is treated as occurring first, it would be deducted against the current income tax base, but would have no effect beyond the current taxable year.

186. See Andrews, *Reporter's Study*, *supra* note 10, at 512, 546. The only plausible reason for thinking that this problem is confined to large trusts is that such trusts could avoid making distributions. However, there are other ways of dealing with that problem. See *infra* text accompanying notes 212–13. Moreover, it is simply a conceptual error to think that the accession occurs at the time of a transfer into trust.

187. A withholding tax would be imposed on the trust when receiving the funding gift or bequest; thereafter, distributions of income and corpus would be grossed-up by the appropriate share of the withholding tax, and the same grossed-up amount would produce a tax credit to the distributee receiving the grossed-up amount.

188. See *supra* notes 155–71.

189. See Andrews, *Reporter's Study*, *supra* note 10, at 544–64 (requiring twenty pages to explain the withholding/credit system it proposes). A similar withholding/credit scheme (known as the “throwback rule”) existed for a long time as a means of taxing trust accumulated income (previously taxed to the trust) at the marginal rates of distributees upon distribution. See I.R.C. § 665 (1994 & Supp. II 1996). This scheme was repealed for most trusts in 1997, partly because of its complexity. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 507(a)(1), 111 Stat. 788, 856 (codified as amended at 26 U.S.C. § 665(c) (2006)).

190. No withholding/credit scheme (of any type in any country) that I know of bears interest. Withholding/credit schemes have been a common technique of mitigating double corporation/shareholder taxation of dividend distributions. STAFF OF JOINT COMM. ON TAXATION, 101ST CONG., *FEDERAL INCOME TAX ASPECTS OF CORPORATE TAX STRUCTURES* 89–90 (Comm. Print 1989).

191. See Andrews, *Reporter's Study*, *supra* note 10, at 557–64 (adopting a credit-ratio approach, whereby the credit would equal the accession times the ratio of the estate tax to the trust, but at any time aggregate credits would not be able to exceed the withholding tax augmented by 6% simple interest). This system essentially allows aggregate credits to grow at a rate at the lesser of (a) the actual yield rate, or (b) the specified interest rate.

192. The basic problem is that only those distributees whose distributions were reduced by the withholding tax should obtain the benefit of the credit (and the burden of the gross-up). In the throwback-rule context, see *supra* note 189 and accompanying text, the withholding tax was “on” accumulated income. In the case of corporate/shareholder imputation systems, the withholding tax was

problems would arise where an accession confers a credit on a distributee greater than the accessions tax currently due.¹⁹³ Deferral is a nonproblem that can only generate a nonsolution.

It is conceivable that the double taxation of income distributions from trusts would be a focal point for political opposition to enactment of an accessions tax, just as the double-taxation-of-capital argument has been used to argue for repeal of the estate tax.¹⁹⁴ To eliminate the appearance of double taxation of income, the accessions tax could be modified by shifting the tax treatment of trusts (or perhaps only large trusts) from an accessions tax mode to an income-inclusion mode. Here the trust would be treated as a taxpayer, so that the receipt by the trust of transfers into the trust would be subject to immediate tax.¹⁹⁵ In order to preclude the use of trusts to avoid high accessions tax rates, the tax would be imposed at a high flat rate without any exemption.¹⁹⁶ The tax on accessions by the trust would be payable by the trust. (The system could be tweaked so that certain favored assets—such as family farms—would avoid tax but at the cost of being assigned what amounts to a zero basis, so that a later sale would generate tax in full.) Thereafter, trust income would be taxed under Subchapter J of the income tax. The *appearance* would be of taxing corpus and income separately, although in fact the income would really be taxed twice.¹⁹⁷

This income-inclusion approach to trusts may also be appealing to accessions tax advocates who have (unjustified) qualms about deferral, and it would avoid the problems of a withholding/credit approach. Nevertheless, in no way can this approach be said to be neutral as between trust and nontrust transfers, because the *ex ante* tax on the trust would be borne by its beneficiaries without reference to their prior

"on" corporate profits available for the payment of dividends. However, in the context of the accessions tax the burden of the withholding tax would not always be clear. Annuity and discretionary distributions would appear not to be burdened. The credit-ratio approach of the ALI Study simply assumes that all distributees suffer proportionately.

193. If the credit generates a current tax refund, the net effect would be a transfer from other trust beneficiaries to the distributee obtaining a refund. The credit might be carried forward, but that distributee might never incur accessions tax sufficient to absorb the credit. Carry-forwards (and possible transfers of unused credits) would add further complexity to the system. If the credits are never used (which is possible), then the government obtains an undeserved windfall.

194. See GRAETZ & SHAPIRO, *supra* note 31, at 7, 55, 83, 129, 140-44 (making the double-taxation-of-capital argument in the political arena, not the academic arena).

195. It would be immaterial if this tax were called an income tax, an estate tax, an accessions tax, or an excise tax.

196. There are three possible approaches to an exemption. One is that the system described in the text could be made to apply to all trusts without any exemption. Second, the system could be made to apply to all trusts, but with a modest exemption amount for each trust. Third, the system could be made to apply only to trusts over a certain amount, but without exemptions. For the second and third alternatives, technical issues would be raised, such as whether multiple trusts of a grantor should be combined. Trusts not subject to the system would be taxed under the deferred-distribution mode.

197. See discussion *supra* note 166 and accompanying text.

accessions history. If the trust were of the discretionary variety, the burden of the trust tax could be shifted among beneficiaries at will.

5. Powers of Appointment

Under the current transfer taxes (as well as the income tax), a person having an inter vivos general power of appointment over trust property is treated as the owner, even if the power is never exercised.¹⁹⁸ Furthermore, possession by a person of a testamentary general power causes property to be included in a person's gross estate.¹⁹⁹ If current estate, gift tax, and income tax rules pertaining to trusts were imported into the accessions tax, then any person holding a general power of appointment under a trust could be treated as being in receipt of an accession without actually receiving a distribution.²⁰⁰

It makes no sense for a person to be treated as receiving an accession on account of being given a power to obtain property only for one's estate (a testamentary general power), because said person is dead at the moment the power becomes exercisable. A person's estate is not a taxpayer under the accessions tax. The alternative of treating the *acquisition* of a testamentary general power as the equivalent of receiving a remainder interest would be inconsistent with the system of taxing only trust distributions (as opposed to taxing trust interests).

There are numerous reasons not to treat the acquisition of an inter vivos general power as an accession. First, the targeted purpose of the accessions tax is to cut down on undue accumulations of unearned wealth. A person does not accumulate unearned wealth simply by having the unexercised power to obtain it during life. Second, treating the acquisition of an inter vivos general power as the equivalent of acquiring fee ownership would likely force the donee of the power to exercise it (at least in part) in order to obtain the cash to pay the accessions tax. Third, such a rule would often be a trap for the unwary, because the distributions to persons other than the donee of the power would also constitute accessions.²⁰¹ Finally, clever estate planners could use general powers as a means of avoiding accessions tax. A fairly obvious technique would be to give a general power over a trust benefiting the higher-

198. See I.R.C. §§ 678, 2041(a)(2) (2006). If the power is exercised, the exercise constitutes a transfer for gift and estate tax purposes by the person holding the power. See *id.* § 2514(b).

199. *Id.* § 2041(a)(2). The release or lapse of a general *testamentary* power is treated as a transfer of a remainder interest following the death of the holder of the power.

200. Thus, a transfer by *D* into a trust under which *B* has a lapsing withdrawal power is treated as a gift from *D* to *B* and, upon the lapse of the power, from *B* back to the trust. See Treas. Reg. § 20.2041-3(d)(3) (1997).

201. Assume that *A* creates a trust, income to *B* for life, with *C* being given an inter vivos general power of appointment, remainder to *R*. If *C* were considered the owner by reason of the general power, *C* would have acceded to the trust upon its creation, and distributions to *B* would be accessions to *B* (from *C*). The same interest would be taxed to two different persons.

bracket spouse to the lower-bracket spouse: thus, if *U*, a relative of *W* (in a higher accessions tax bracket than her spouse *H*), creates a trust for the benefit of *W*, giving *H* an inter vivos general power (but with the understanding that it won't be exercised except to pay accessions tax), the transfer into trust would be an (accelerated) accession by *H*, and distributions to *W* would be exempt under the spousal exclusion, because *H* would be treated as the transferor! In a single-beneficiary trust, giving the beneficiary an inter vivos general power would accelerate the taxable event.²⁰²

Thus, there is no doubt that the *possession* of a general power of appointment should be ignored under the accessions tax.²⁰³ Therefore, the only accessions with respect to trusts would be actual distributions. Distributions could, of course, be triggered by the *exercise* of *both* special and general powers.²⁰⁴ With regard to both possession and exercise, the distinction between general and special powers would be irrelevant, and there would be no need to construct an accessions tax definition of "general power of appointment." Lapsing withdrawal powers would have no significance unless the power is exercised. Powers of appointment can reduce aggregate accessions tax by being exercised in a way that disperses wealth, but that is the nontax aim of the accessions tax. Powers of appointment are desirable for nontax reasons, because they provide flexibility and reduce dead-hand control.

Since a person's estate is not a taxpayer for accessions tax purposes, an appointment to a person's estate, or a distribution of a sum of money to a person's estate under a contract, would generally be accessions only to the extent such amounts are distributed to estate beneficiaries. However, amounts that are used to pay debts of the decedent perhaps should be treated as (posthumous) accessions of the decedent.²⁰⁵

202. For example, assume that *A* creates a trust, income to *B* for life, corpus payable to *B* in the trustee's discretion, with *B* being given a general inter vivos power of appointment. If *B* were considered the owner by reason of the general power, *B*'s accession would be at the inception of the trust, not when *B* receives distributions. Lapsing powers could be used for the same purpose, and might even result in total tax avoidance. Assume that *A* creates a trust, income to be accumulated until *B* reaches the age of forty-five, giving *B* an annual lapsing power, and a general inter vivos power over the whole on reaching age forty-five. If the lapsing power were recognized, then each lapse would be a transfer from *A* to *B* (that might possibly fall under the annual exclusion for gifts!), and the lapsed amount would be a transfer from *B* to the trust. Actual withdrawals by *B* after age forty-five would be exempt to the extent that *B* was the transferor of the trust.

203. The ALI Study is ambivalent concerning the treatment of general powers of appointment. See Andrews, *Reporter's Study*, *supra* note 10, at 510-12, 534.

204. In a single-beneficiary trust, a power could be exercised in favor of the beneficiary to accelerate the accession.

205. Suppose that *A* created a trust, giving *B* a testamentary general power of appointment, with specified takers in default. At *B*'s death, *B* has assets of \$500,000 (and debts of \$100,000), the trust is worth \$1 million, and \$120,000 of the trust is appointed (under *B*'s will) to *B*'s estate. In the absence of the exercise of the power, *B*'s net estate (accessions to *B*'s legatees) would have been \$400,000 and the

6. *Assignments of Trust Interests*

Suppose *A* creates a trust with \$1 million, income to *B* for life, remainder to *C*. Either or both of *B* and *C* could sell their interests to strangers at arm's length. The effect of selling their interests on the market would be to accelerate the accession.²⁰⁶ Arm's length transactions of this sort are likely to be uncommon, however, because a buyer would probably insist on a hefty discount from the actuarial value of an interest,²⁰⁷ and the income tax consequences of selling an income interest are unfavorable.²⁰⁸

A sale of a trust interest to a *related party* raises a more fundamental problem than that of acceleration, namely, that of a disguised gratuitous wealth transfer to the buyer.²⁰⁹

7. *Generation-Skipping Trusts*

The notion of taxing undue accumulations of unearned wealth does not imply any kind of generation-skipping tax. The relevant fact is only a person's receipt of unearned wealth. The generational source of the wealth is irrelevant.²¹⁰

It is true that one can construct an "equity problem" by pointing out that a bequest by grandparent to parent followed by a bequest of the same amount from parent to grandchild is potentially subject to accessions tax twice, whereas a bequest of the same amount from grandparent to grandchild is potentially subject to tax once. However, the actual tax burden would be the same if the accession of the parent avoids tax by reason of falling within the parent's lifetime exemption. In any event, even if one scenario results in a greater tax than the other, inequity exists only if the two situations are the same, which is not the case at all. In the first scenario, both the parent and grandchild received accessions; in the second, only the grandchild received an accession. Moreover, the comparison assumes that the first scenario describes two

accessions from the trust to the takers in default would have been \$1 million in the aggregate. The partial exercise of the power in favor of *B*'s estate should have the following consequences: (1) accession by *B* of \$100,000 on account of paying off *B*'s debts, (2) accessions by *B*'s legatees of \$520,000, and (3) accessions to the takers in default of \$880,000. Although *B* is now dead, she obtained economic enjoyment of the appointed amount of \$100,000 during her lifetime by way of incurring debts and appointing \$100,000 of trust assets to satisfy these debts. *B*'s distributable estate is now increased to \$500,000 by reason of the satisfaction of these debts. The additional appointment of \$20,000 to *B*'s estate merely shifts the identity of the transferee of that \$20,000 from the trust takers in default to *B*'s estate beneficiaries, but it did not benefit *B* personally.

206. See Andrews, *Reporter's Study*, *supra* note 10, at 529.

207. The market for trust interests is very thin, and a market buyer would be concerned that the seller would not disclose facts bearing on longevity.

208. The basis of a term interest is zero under section 1001(e). I.R.C. § 1001(e) (2006).

209. This issue is discussed *infra* Part IV.E.3.

210. For a fuller exposition of this basic point, see *supra* text accompanying notes 73-74.

taxes on the "same dollars," whereas the accession by the grandchild may derive in whole or in part from new wealth earned by the parent.

Viewing the matter from a more distant vantage point, it is statistically probable that grandchildren, as a class, are more needy than children as a class, because statistically children are likely to receive bequests from their parents during their prime earnings years, whereas grandchildren are statistically likely to receive bequests from grandparents in early adulthood. An accessions tax tends to steer bequests to beneficiaries in need rather than to those not in need, and that tendency is desirable from a welfarist point of view. A generation-skipping tax (surtax on accessions by grandchildren) would violate the norm of economic neutrality and create a perverse incentive structure.

8. *Dynastic Trusts*

With no generation-skipping tax, it might be claimed that the accessions tax would create a strong incentive to create dynastic trusts to accumulate income indefinitely. However, the only clear incentive would be to create discretionary trusts that allow trustees to direct distributions to persons who are in zero or low accessions tax brackets, which precisely accords with a principal purpose of the tax to cause unearned wealth to be dispersed. There already exists a tax disincentive for trust accumulations, namely, the compressed income tax brackets for trusts (that are taxed on undistributed net ordinary income).²¹¹ If this disincentive is deemed insufficient (perhaps due to the possibility of achieving growth through appreciation and capital gains), Congress can enact a minimum distribution rule, as it has already done for private foundations.²¹²

There are ways to deal with the perpetuity problem: (a) enacting a federal rule against perpetuities (as a rule limiting duration, rather than relating to vesting); (b) imposing a requirement (after the trust reaches a certain age) of a relatively high mandatory payout rate likely to result in the exhaustion of corpus; (c) allowing beneficiaries to easily modify or terminate dynastic trusts and replace trustees; (d) imposing an (additional) inception tax on trusts that could last longer than a fixed period (say, eighty years); and (e) imposing periodic taxes on trusts that have in fact exceeded a certain duration.²¹³

211. See I.R.C. § 1(e) (providing that only modest amounts are taxed at rates below 35%).

212. *Id.* § 4942(e)(1)(A) (providing for excise tax on failure to distribute amount equal to 5% of private foundation's net asset value).

213. For an argument that a tax on (intangible) personal property should not be viewed as a "direct tax" within the meaning of the U.S. Constitution, notwithstanding the second decision in *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895), see Joseph M. Dodge, *What Federal Taxes Are Subject to the Rule of Apportionment?*, 11 U. PA. J. CONST. LAW 839 (2009).

C. NONTRUST SUCCESSIVE-INTEREST ARRANGEMENTS

Successive interests in fee or under contractual arrangements (including life insurance) would be treated in a way similar to that of trusts. As is the case with trusts, the deferral approach proposed here would be simpler and less subject to abuse than current law.

1. *Legal Life Estates*

The actual-distribution approach does not work for purely possessory interests (such as legal life estates).²¹⁴ The mere use of property is not considered to be income under the income tax, and does not entail a distribution in the normal sense. On the other hand, a transfer of the use value of money is treated as a gift under the current gift tax.²¹⁵ Moreover, exempting possessory interests from the accessions tax would create a strong tax incentive to use them, despite various nontax reasons to avoid them.²¹⁶

There are at least two possible approaches to this problem: (1) deeming an annual distribution determined according to some objective measure, such as the rate on Treasury bills (the imputed income approach);²¹⁷ or (2) treating the receipt of the life estate as an accession measured by its actuarial value.²¹⁸ Neither approach is very accurate, but hopefully that won't matter much, as legal life estates are rarely used by the wealthy.

A legal life estate coupled with a power to consume (or its equivalent) should be treated as a fee simple absolute for accessions tax purposes, even if the power is limited by a standard, because the possibility that the standard would limit absolute enjoyment is incapable of any kind of accurate measurement.

The remainder interest would be taxed the same as if it were a remainder in trust, that is, the entire value of the property would be an accession when the remainder interest comes into possession.

2. *Joint Tenancies with Rights of Survivorship*

The creation of a joint tenancy with right of survivorship entails the fractionalization of the property into an aggregation of contingent interests, some of which are retained by the donor. Accessions would

214. A trust that holds a tangible asset (such as a personal residence) that a beneficiary uses or enjoys would be treated as if the beneficiary held an estate in the property directly.

215. See I.R.C. § 7872(a), (d).

216. See JESSE DUKENMINER ET AL., PROPERTY 203-04 (6th ed. 2006) (stating strong preference for trusts over legal life estates for nontax reasons).

217. Imputed income regimes have been attempted, but they have failed due to an unwillingness and/or inability to revise valuation as the years pass. MICHAEL J. GRAETZ & DEBORAH H. SCHENK, FEDERAL INCOME TAXATION 133 (6th ed. 2009).

218. The discount rate for valuing a life estate should be deemed to be higher than the safe interest rate assumed by conventional actuarial tables on account of the fact that the life tenant has management powers and is subject to only weak duties towards the holder of the remainder interest.

occur (unless exempt under the spousal exclusion) only when contingencies are actually removed, namely, withdrawal (from a joint account), partition, and coming into fee ownership upon a person's death.²¹⁹ The "consideration exception" for transfers to oneself would, of course, come into play.

The creation by *A* of a joint tenancy with right of survivorship in *B* and *C* would be governed by similar principles, except that no consideration exception would apply.

3. *Contract Rights*

Survivorship rights and benefits under annuities and employee retirement plans would count as accessions only upon distribution, except to the extent that the recipient was also the transferor. Many such distributions would be covered by the spousal exclusion. The creation of such rights would be ignored, as under the current gift tax, where the beneficiary's rights can be revoked or altered.

Nonrevocable gifts in this area are uncommon, but no persuasive reason exists to treat gifts of rights that cannot be accurately valued (or that might be forfeitable) as closed transactions, as occurs under the present gift tax.²²⁰ Since the acquisition of contingent rights would be a nonrealization event under the income tax,²²¹ a similar result should occur under an accessions tax. Thus, only the actual receipt (or withdrawal) of cash would be an accession as and when it occurs.

4. *Life Insurance*

In the abstract, designing transfer tax rules for life insurance proceeds is difficult, because of the difficulty of ascertaining the economic source of the proceeds. Two competing paradigms exist. One is the gratuitous receipt paradigm, in which the beneficiary is neither the owner of the policy nor the insured. The other is the investment paradigm, in which the purchaser of the policy is the beneficiary. In the gratuitous receipt scenario, the beneficiary clearly has an accession upon receiving the proceeds, but not income or gain under the income tax. In the investment scenario, the beneficiary-purchaser obtains investment gain upon receiving the proceeds,²²² but not an accession. These

219. Acquiring the "right to partition" is the equivalent of an inter vivos general power of appointment over half the property. Like general powers, such a right would be ignored. The ALI Study would treat the creation by *A* of a survivorship joint tenancy in *A* and *B* as a gift of half. Andrews, *Reporter's Study*, *supra* note 10, at 538. If *A* dies first, *B* would accede to the other half. If *B* dies first, *A* has no accession, since *A* is the transferor.

220. See *Estate of DiMarco v. Comm'r*, 87 T.C. 653, 661 n.8 (1986) (rejecting "open gift doctrine"), *acq. in result*, 1990-2 C.B. 1.

221. See I.R.C. § 83(a) (2006) (stating that substantial risk of forfeiture triggers deferral); Treas. Reg. § 1.83-7 (as amended in 2004) (stating that nontransferability of options triggers deferral).

222. Here, *B* is an investor with a cost basis or a carryover "gift" basis, or some combination of both.

paradigms suggest a solution: life insurance gains of a beneficiary should be taxed under either the accessions tax or the income tax, but not both. The question is where to draw the line in the gray area, namely, where the beneficiary acquired the policy from, or with the assistance of, the insured. The current income tax treats virtually all gray area situations as involving excluded gratuitous receipts.²²³ This approach makes sense, because the insured is usually involved in the application for the policy, and it is easy for the insured to finance the beneficiary's nominal ownership of the policy without detection by the IRS.

Thus, the accessions tax would reach insurance receipts of a beneficiary except in those few cases where such receipt produces includible gain under the income tax. Inclusion in the accessions tax base (subject to the spousal exclusion and lifetime exemptions) is a reasonable price for a beneficiary to pay for permanent exclusion from the income tax of not only the actuarial gain, but also on any inside build up. It follows from this either-or approach that a beneficiary receiving life insurance proceeds would obtain an offset for premiums paid by the beneficiary only in the investment scenario.²²⁴ That is, where the receipt of the proceeds is treated as an accession, there would be no offset or exclusion by reason of the beneficiary's investment. Although this rule appears to contradict the exclusion for transfers to oneself, the rule is a reasonable solution to two intractable factual problems. One is the extent to which the premiums were really paid by the beneficiary (rather than the insured), but there is no feasible way for the government to monitor the possibility that the insured supplied the beneficiary with money to pay the premiums.²²⁵ The other problem is the economic relation of premiums to proceeds (which varies according to the type of policy).²²⁶ Even if the source of the premiums could be identified, the legal consequences that should flow therefrom are not at all clear. The

223. Beneficiary investment gains are subject to income tax only if (with some exceptions) the beneficiary purchased the policy from its original owner. See I.R.C. § 101(a)(2).

224. Under the ALI Study, a beneficiary acquiring ownership by gift would be given "credit" against the accession amount for premiums paid with his own funds. Andrews, *Reporter's Study*, *supra* note 10, at 557-64.

225. An analogous problem exists under section 2040(a), dealing with inclusion in the gross estate of joint tenancy property. I.R.C. § 2040(a). There, the solution is to impose a rebuttable presumption that the decedent created the joint tenancy (which presumption, where not rebutted, resulted in full inclusion of the property in the decedent's gross estate). *Id.* In the life insurance context, a presumption that persons other than the beneficiary paid the premiums would be hard to rebut, especially for years long past.

226. In the case of pure term insurance, the last premium purchases the entire proceeds. In the case of ordinary life insurance, an issue is whether the beneficiary should obtain credit for (a) the cash surrender value, (b) the premiums paid by her, or (c) the portions of the premiums allocable to the savings component (cash surrender value) rather than the actuarial pool for the year. In any event, a proportionate-premium rule is not accurate, because a premium paid earlier may contribute a greater (or lesser) amount towards the cash surrender value than a later premium of equal amount.

bottom line is that life insurance should not escape both income tax and accessions tax.²²⁷

Under current law, irrevocable gifts of unmatured policies are a common device for reducing transfer taxes, because the gift tax value is (usually) substantially less than the estate tax value.²²⁸ As explained above, under the accessions tax the proceeds would always be taxed (either as an accession or in computing income tax gain), and hence there would be no reason to treat a gift of a policy as an accession.²²⁹ On the merits, a gift of an unmatured life insurance policy resembles a gift of a contingent right insofar as the potential actuarial gain is concerned. Although the donee may acquire a right to withdraw the cash surrender value, that right is akin to an inter vivos general power of appointment, which in a trust context would be ignored. Of course, any withdrawal of cash from the policy by the donee prior to the insured's death would be treated as an accession.²³⁰

The approach suggested here removes the current transfer tax advantages attendant upon gifts of life insurance and arrangements involving beneficiary-owned life insurance. Furthermore, the approach offers vast simplification advantages. It would eliminate both the issue of who possessed the "incidents of ownership" over the policy at the insured's death and the possible issue of who "transferred" the proceeds to the beneficiary through the payment of premiums. The valuation of unmatured policies would no longer be necessary. Transfers of insurance policies in proximity to death would not be of concern.²³¹

D. TAX-AVOIDANCE SCHEMES INVOLVING (NONCHARITABLE) SPLIT INTERESTS

The current gift and estate tax offers no consistent principle as to the timing of transfers. Actuarial tables are used to value successive interests in property.²³² Various devices are designed to exploit these timing and

227. Reasonable people might disagree as to where the line should be drawn between the accession and investment categories. The ALI Study would treat the proceeds as an accession in any case except where the beneficiary was the original owner of the policy. Andrews, *Reporter's Study*, *supra* note 10, at 535-36.

228. Under the current gift tax, the gift amount is the "interpolated terminal reserve" (information that can only be obtained from the insurance company) plus the unexpired premium. See Treas. Reg. § 25.2512-6(a) (as amended in 1974).

229. A bequest of an unmatured policy would not result in an immediate accession; the accession would occur when the policy matures and the proceeds are paid.

230. Accord Andrews, *Reporter's Study*, *supra* note 10.

231. Under current law, a gift of a policy within three years of death is disregarded for estate tax purposes. See I.R.C. § 2035(a)(2) (2006).

232. Briefly (and as a crude generalization), actuarial tables are used (*inter alia*) to value certain charitable lead and remainder interests and certain gifts of present and future interests. See I.R.C. §§ 2055(e), 2522(c), 2702, 7520.

valuation rules to the systematic advantage of taxpayers.²³³ On one level, the problem is that of accuracy of valuation. On another level, the problem is the concealment of gratuitous transfers that occur passively by reason of the passage of time, as well as by the shifting of economic return between successive interests within the investment vehicle.²³⁴ Unlike the estate tax, the accessions tax can deal with these problems by taking a wait-and-see approach.

1. Retained-Interest Transfers

Suppose *X* creates an inter vivos trust with \$10 million, income to *X* for life, remainder to *Y*. If the transfer is deemed to be complete upon creation of the trust, the gift (under current law) is only of the actuarial value of the remainder interest.²³⁵ However, under current section 2036(a)(1), this trust is included in *X*'s gross estate at its estate tax value, thereby negating any possible advantage of a gift tax undervaluation of *Y*'s remainder interest.²³⁶ Nevertheless, a so-called GRAT (grantor retained annuity trust) can achieve the desired tax planning result, if the retained interest in *X* is: (a) a qualified annuity interest, (b) the annuity is for a period of years (rather than for *X*'s life), and (c) *X* outlives the annuity period. If these requirements are satisfied, the trust is not included in *X*'s gross estate, and the amount taxed (under the gift tax) is the actuarial value of *Y*'s remainder interest.²³⁷

Probable undervaluation of the remainder interest is partly a by-product of the "subtraction method," which means that the value of the remainder interest is the gift-time value of the entire property (\$10 million) less the actuarial value of the annuity,²³⁸ which can be structured to approach \$10 million,²³⁹ leaving a very low value to the remainder

233. See Cooper, *supra* note 15, at 170–210 (diagnosing tax-avoidance schemes); Joseph M. Dodge, *Redoing the Federal Estate and Gift Taxes Along Easy-to-Value Lines*, 43 TAX L. REV. 241, 345–54 (1988) (proposing hard-to-complete rules under the current system).

234. Thus, if a trust provides for income to *B* for life, remainder to *C*, the value of the interests of *B* and *C* can be manipulated through investment strategies and trust accounting practices.

235. See Treas. Reg. § 25.2511-1(e) (1997); *id.* § 25.2512-5(a) (2000).

236. Actually, under section 2702, the amount of the gift would *not* be reduced by the actuarial value of the income interest, because an income interest cannot be a "qualified (annuity or unitrust) interest." I.R.C. § 2702.

237. The GRAT (as well as the GRUT, or grantor retained unitrust) is expressly allowed under section 2702, which values the remainder interest for gift tax purposes, and section 2036(a)(1) is avoided because *X*'s retained interest expires at death. See *id.* §§ 2036(a)(1), 2702. In contrast, a trust in which the grantor retains an interest that is not a qualified annuity or unitrust interest is taxed under the gift tax as if the retained interest were also the subject of a gift, that is, the retained interest is not subtracted. See *id.* § 2702(a)(2)(A).

238. See *id.* § 2702(a)(2) (mandating use of actuarial tables prescribed under section 7520); Treas. Reg. § 25.2702-1(b) (1960).

239. An annuity with a specified pay-out amount greater than the income return assumed by the actuarial tables depletes the corpus. For example, using the tables that assume a 6% rate of return (and discount rate), an annuity for a person age fifty would be worth \$1 million if the annual payout is \$78,431. Stated differently, if a person created a GRAT at age fifty with a specified retained annuity

interest. The subtraction method assumes that the economic return on \$10 million is entirely devoted to feeding the retained annuity. The taxpayer, however, anticipates that the return will be high enough to feed the annuity *and* augment the lightly-taxed remainder. In a market setting, bifurcation into successive interests can produce parts that add up to an amount greater (or lesser) than the whole. That is, parties may be willing to pay a greater (or lesser) aggregate amount for successive interests than one person would pay for a fee interest (or two persons would pay for undivided fractional interests in the property), because one or more interests may possess option value, and/or each buyer might overestimate factors (life spans, economic returns, the behavior of agents) that would operate to benefit her interest relative to the other interest.

The GRAT flunks the smell test: nobody would buy an annuity that was expected to expire before death, because the whole point of an annuity is to protect against the risk of longevity. The accessions tax would effectively abolish the GRAT, because the creation of the trust would not be a taxable event, and the coming into possession of the remainder interest would be a taxable accession to *Y* in full.

2. *Sale of a Remainder Interest*

Suppose *C*, owning Blackacre worth \$1 million, sells a remainder interest in Blackacre to her child *D* for its actuarial value of, say, \$300,000, retaining a life estate (having a then actuarial value of \$700,000). *D* would claim that the appreciation in the remainder is not an accession at all but the gain from an investment. Under current law, this transaction probably avoids estate tax on the theory that *C* has made a sale (of the remainder interest) for full and adequate consideration, and has not (therefore) depleted her estate.²⁴⁰ Under an accessions tax, the focus shifts to the recipient, so that the problem is to determine what *D* has *received by reason of a gratuitous transfer* by *C*.²⁴¹ (What *C* did with the \$300,000 is immaterial to *D*.) Although the purchase of the remainder interest by *D* would not *then* entail an accession by *D*, neither should it "close" the transaction, because, subsequent to the purchase, the purchaser (*D*) has passage-of-time gain that mirrors the passage-of-

payout of \$78,431, the value of the remainder would be zero ($\$IM - \$IM = 0$).

240. See *Estate of D'Ambrosio v. Comm'r*, 101 F.3d 309, 314 (3d Cir. 1996) (holding that sale of remainder interest for full value avoids section 2036). *Contra* *Gradow v. United States*, 11 Cl. Ct. 808 (1987), *aff'd*, 897 F.2d 516, 519 (Fed. Cir. 1990). Nevertheless, the full value of the property, minus the consideration, is currently subject to gift tax, but only under a special statutory anti-abuse provision, section 2702(c)(2), which is avoidable. See I.R.C. § 2702(c)(2). It only applies if there is a joint purchase (in the same transaction or series of related transactions) of property by "members of the same family," as defined in section 2704(c)(2). *Id.* § 2704(c)(2). In addition, it does not apply to a personal residence trust as defined in section 2702(a)(3)(A)(ii). *Id.* § 2702(a)(3)(A)(ii).

241. See *Andrews, Reporter's Study*, *supra* note 10. The ALI Study did not anticipate this problem.

time loss to the seller (*C*). The gain to *D* is not market appreciation, but is instead inevitable gain resulting from *C*'s act of bifurcating the property into successive interests.²⁴² *The shifting of wealth between related parties is what defines a "gratuitous transfer."* This gratuitous transfer is finally "realized" for accessions tax purposes when *C*'s interest terminates and *D*'s interest comes into possession.²⁴³ The amount of *D*'s accession is the then value of Blackacre minus the \$300,000 consideration paid by *D*,²⁴⁴ because (but for the consideration) the value of Blackacre at the termination of *C*'s interest would be the measure of the accession.²⁴⁵ Stated differently, the "sale" aspect of the transaction only removes the sale price amount from the accession amount. That *D* might have invested the \$300,000 in an alternative investment to produce substantial gain is immaterial, because the accessions tax is a tax on gratuitously-received wealth, whereas it is the income tax that reaches investment gain. This point is all the more telling, because in the remainder-purchase transaction *D* can avoid income tax on the passage-of-time gain,²⁴⁶ leaving the accessions tax as the sole backup.

3. Private Annuities

In a private annuity transaction, appreciated-value property (Blackacre) is sold by *X* to related-party *Y* for *Y*'s promise to pay *X* an annuity for *X*'s life. Under current law, there is no gift if the value of the annuity promise, using actuarial tables, equals the value of Blackacre at the time the transaction is entered into.²⁴⁷ Also, the property avoids inclusion in the gross estate on the technical ground that the annuity is

242. With the passage of time, the gain to the remainder interest (coming closer to possession) exactly equals the loss to the term interest (coming nearer to termination).

243. See *D'Ambrosio*, 101 F.3d at 320 (Cowen, J., dissenting). A similar point is made in regard to section 2036(a) of the current estate tax: the whole purpose of section 2036(a)(1) is to defeat acceleration of the taxable event to the date the remainder interest is created. *Id.*

244. The proportionate-consideration rule applicable to joint transfers, see *supra* note 91 and accompanying text, would not apply in successive-interest situations, because there is no joint contribution to a common pot.

245. The purchase of a remainder interest does not create original issue discount under the income tax (there being no stated redemption price at maturity), and the coming into possession of a remainder interest is not considered to be a realization event under the income tax. See I.R.C. §§ 643(e), 1014. Moreover, *Y*'s basis might be something other than cost.

246. The coming into possession of a purchased remainder is not a realization event, but merely a change in form of an existing property interest. If the remainder interest is not in trust, it appears that *D*'s initial \$300 basis can be increased over time by as much as \$700,000 (at least if *C* and *D* jointly purchased Blackacre for \$700,000 and \$300,000 respectively). See I.R.C. § 167(e)(3). If the remainder interest is in a trust, the inside basis of the trust assets (possibly \$1 million) carries over to the distributee under section 643(e)(1) (the distributee, *D*, would be taxed only on the net income of the trust, if any, in the year of termination). See *id.* § 643(e)(1).

247. See Rev. Rul. 69-74, 1969-1 C.B. 43.

not a retained interest "in" Blackacre,²⁴⁸ at least so long as the annuity promise is not tied to Blackacre itself.²⁴⁹

The private annuity resoundingly fails the smell test. A person seeking to acquire an annuity would bid a very low price for an unsecured private annuity promise of an individual whose financial condition may be marginal. On the other side, no sane private individual would undertake to pay an annuity of a substantial amount to a stranger for life, undertaking the risk that the stranger might outlive his life expectancy. That being the case, a private annuity cannot realistically be considered to be a form of insurance against longevity. As a transaction among related parties, a private annuity transaction only makes sense in cases where *X* is expected to die soon after the transaction is undertaken.²⁵⁰ The whole point is the expectation that the promisor's payment obligation will lapse prematurely.

Under an accessions tax, one solution is to treat the transaction as a gift by valuing the annuity promise at its low fair market value (rather than its actuarial value). Since there is no market for private annuity promises, the fair market value might even be said to be zero. However, since the promise probably has some (if an uncertain) value, the most accurate approach would be to hold the transaction open until *X*'s death.²⁵¹ At *X*'s death, the accession amount is the then value of the property less the amount actually paid for it.

4. *Lapsing Restrictions and Charges*

A current-enjoyment interest (such as a life estate, income interest, or annuity) retained by a transferor of property can be characterized as a charge or restriction on the transferred property that, upon its lapse, amounts to a second gratuitous transfer, because, at the moment of lapse, wealth shifts from the transferor to the transferee by conscious design. For accessions tax purposes, it is immaterial that the charge is "on" the property directly. What is important is that the charge (obligation) is imposed on the transferee as a condition of receiving the transfer. When the obligation disappears, the transferee is enriched by wealth that flows

248. See *Fidelity-Philadelphia Trust Co. v. Smith*, 356 U.S. 274, 280 n.8 (1957).

249. See *Estate of Bergan v. Comm'r*, 1 T.C. 543, 545 (1943) (distinguishing cases where annuity was secured by the transferred property).

250. See, e.g., *Estate of Fabric v. Comm'r*, 83 T.C. 932, 943 (1984) (upholding private annuity transaction despite having been created during health crisis that led to the grantor's death shortly thereafter). Actuarial tables must be used to value annuities unless the taxpayer is terminally ill (there is at least a 50% probability of death within twelve months). See *Treas. Reg. § 20.7520-3(b)(3)(i)* (1989).

251. The open-transaction doctrine has long been accepted as an aspect of the realization requirement under the income tax. See *Burnet v. Logan*, 283 U.S. 404, 413-14 (1931) (contingent-payment sales); *Rev. Rul. 58-234*, 1958-1 C.B. 279 (open-transaction treatment of put and call options); *Treas. Reg. § 15a.453-1(d)(2)(iii)* (1969).

from the transferor. The income tax analogy is debt-discharge income.²⁵² An accessions tax application of this principle (besides the situations already noted) is the installment sale to a related party where the installment obligation either is cancelled or lapses by its terms.²⁵³

The current system recognizes that the lapse of a restriction constitutes a gratuitous transfer only in limited circumstances, namely: (a) the lapsing right must be a voting or liquidation right in a business entity, (b) the person holding the lapsing right must control (along with "members of the family") the entity both before and after the lapse, and (c) the lapse must occur during the person's life or at his death.²⁵⁴ Under an accessions tax, none of these limitations would apply. It would be sufficient that any restriction or charge depressing the value of property was imposed by one or more related parties.²⁵⁵ The lapse would result in an accession even if the person imposing the restriction was no longer on the scene. For example, suppose *X* and *Y* (who are related parties) agree that, on *X*'s death, Blackacre will be sold by *X*'s estate to *Y* for a price that is 20% below fair market value (and that *X* and *X*'s estate will not sell Blackacre to anyone other than *Y*). There is no accession by *Y* upon entering into the agreement, because the value of the future discount is uncertain. Upon the death of *X*, *Y* buys the property, worth \$1 million, from *X*'s estate for \$800,000. The agreement is a restriction on *X* that depresses the value of Blackacre, but upon the satisfaction of the agreement the restriction lapses. At that point, *Y* has an accession of \$200,000.

If a broad lapse rule is recognized, it would not be necessary to disregard restrictions in valuing property at the time property is transferred, as occurs under current law in certain circumstances.²⁵⁶ For example, suppose that *M* creates an LLC to hold *X* Corporation stock,

252. See I.R.C. § 61(a)(12) (2006). Such income arises when a creditor forgives a debtor's obligation to repay an amount received tax free under the "borrowing exclusion" of the income tax.

253. Under current law, the cancellation of installment notes is treated as a gift at the date of cancellation. See Rev. Rul. 77-299, 1977-2 C.B. 343. However, a self-canceling installment note (SCIN) is not treated as a gratuitous transfer if the value of the note (with its self-canceling feature) had a value at the time of sale such that the consideration was full and adequate for the property. See *Estate of Moss v. Comm'r*, 74 T.C. 1239, 1246-47 (1980), *acq.*, 1981-2 C.B. 1. Section 2703(a), dealing with lapsing restrictions, does not apply because that section only pertains to interests in business entities. I.R.C. § 2703(a).

254. See I.R.C. § 2704(a). In addition, if *X* retains voting rights in transferred stock until her death, the stock is included in *X*'s gross estate under section 2036(b) if *X* is deemed to control the corporation. *Id.* § 2036(b).

255. Under the income tax, a lapsing restriction on property or cash can produce gross income. See I.R.C. § 61(a)(12) (cessation of repayment obligation); *id.* § 83(a) (lapse of substantial forfeiture condition on property received from employer); Rev. Rul. 58-234, 1958-1 C.B. 279 (lapse of put or call option).

256. See I.R.C. § 2703 (disregarding restrictions on sale); *id.* § 2704(b) (disregarding restrictions on liquidation of a controlled business entity that might lapse or be removed).

but imposes a restriction on liquidation of the LLC that expires ten years following *M*'s death. *M* makes a gift of the equity in the LLC to *N*. Although the stock of *X* Corporation is worth \$10 million at the time of gift, only \$6 million is treated as the value of the accession to *N* by reason of the restriction. Ten years later, the liquidation restriction lapses, and *N* has a second accession equal to the excess of the then value of the stock over \$6 million.

E. ASSETS DEEMED TO BE NONLIQUID

The accessions tax realization principle allows for the deferral of accessions in the case of in-kind property (not subject to rules discussed above) that is considered to be nonliquid, hard to value, and/or deserving of special transfer tax accommodation. Deferred realization in these types of cases would be conditioned on falling within some qualification rule. Qualified deferral property would yield a realized accession at such time as the asset ceases to be qualified. Since qualification would be tied to nonliquidity, a sale for cash would be the paradigm accession realization event. However, a rule that called for the deferred realization of *all* in-kind property receipts under the accessions tax would be difficult to enforce, because such property would need to be identified as qualified deferred-realization property having, in effect, a "zero basis" for accessions tax purposes. Therefore, the rules should be such that qualified deferred realization property falls into categories that would be easily recognized by the IRS, and that (in turn) implies that the qualification rules should be fairly restrictive.²⁵⁷

1. Equity Interests in Family Enterprises

The lapsing-restriction approach discussed earlier is not useful in the case of the three most common situations in which value is depressed by a transferor, namely, minority-interest discounts (caused by carving minority interests out of a controlling interest),²⁵⁸ lack-of-marketability discounts (caused by folding marketable assets into entities represented by nonmarket equity interests),²⁵⁹ and entity estate freezes (causing the gift of junior equity in an enterprise to appear to be worth a negligible amount).²⁶⁰ The conditions giving rise to these discounts may never lapse

257. *Contra* Pareja, *supra* note 7, at 876 (favoring an income-inclusion system and deferred-realization (with a zero basis) for virtually all assets received in-kind).

258. See *Estate of Bright v. United States*, 658 F.2d 999, 1005-08 (Former 5th Cir. Oct. 1981) (en banc) (bequest of 50% interest in community property); Rev. Rul. 93-12, 1993-1 C.B. 202 (minority interest created by gift).

259. See *Estate of Hall v. Comm'r*, 92 T.C. 312, 340-42 (1989).

260. Junior equity in a family enterprise that is made the subject of a gift to younger-generation person *Y* is subordinated to a senior equity interest retained by senior-generation person *X*. The retained senior equity has a sufficient rate of return to insure that its value is equal, or almost equal, to the current enterprise value, so that the gift of the junior equity to *Y* has a zero or low value. See Treas. Reg. § 25.2701-1(a)(2) (1958). The appreciation potential of the enterprise resides in the junior

or, if they do lapse,²⁶¹ taxpayers and the IRS may be unaware of potential accessions tax consequences.²⁶² In addition, there would usually be no third party to act as reporting agent. These discounts are (with a minor exception applicable to entity estate freezes)²⁶³ recognized under the current estate tax, but with sufficient unease that proposals are generated from time to time for legislative solutions, such as family attribution rules for negating minority status and entity-disregard rules for entities holding marketable investments.²⁶⁴

a. Deferred Accessions for Qualified Equity Interests

The counterposition of taxpayer interests transcends the issue of valuation discounts. The position is that, despite special tax benefits,²⁶⁵ the estate tax causes forced sales of family-owned business and farm interests. The contention has such political traction that it has to be assumed that some family-enterprise interests will be privileged under an accessions tax. The privilege would be that of deferral of the accession until the liquidity/valuation issue is resolved (or can be deemed to be resolved). Deferral would avoid those economic distortions that are designed to provide immediate liquidity to pay the current estate tax, such as purchasing life insurance, entering into buy-sell agreements, or selling the assets at distress prices. Deferral would also naturally filter out the value of lost human capital, which is often a major component of the value of a family business.²⁶⁶

An equity interest in a closely-held enterprise ("qualified equity interest" or QUE) received by gratuitous transfer (or by a family member as the result of a sale or exchange) would be treated as an accession only upon the cessation of qualified status. A QUE would be

equity. The retained senior equity maintains a fairly steady value (hence the term "estate freeze").

261. Minority interests may coalesce into controlling interests, and lack-of-marketability discounts may be obviated in various ways.

262. Such events might not be considered realization or gain-recognition events for income tax purposes. See, e.g., I.R.C. §§ 351(a), 354(a) (2006).

263. Current law allows the gift tax value of the junior equity in entity estate freeze to be equal to the enterprise value reduced by the value of the retained senior equity so long as the senior equity carries with it mandatory distribution rights. See *supra* note 260. If not, the retained right is deemed to be worth zero, thereby increasing the value of the gift. I.R.C. § 2701(a)(3). In any event, the junior equity is deemed to be worth no less than 10% of the net enterprise value. See *id.* § 2701(a)(4). This 10% rule is an implicit acknowledgement of the inadequacy of the subtraction method. Even if the senior equity has a present value equal to the enterprise value, the junior equity still has positive value, because the junior equity has the characteristics of an option in which the potential gain (access to future enterprise appreciation) far exceeds the potential loss (low cost of the option).

264. See Belcher & Fellows, *supra* note 11, at 203-14, 217-18 (discussing valuation issues pertaining to interests in closely-held business entities).

265. See I.R.C. §§ 303, 2032A, 2057, 6166.

266. The fact that closely-held businesses often decline or fail after the deaths of the founding entrepreneur suggests that lost human capital is a major problem. The extent to which the loss of human capital is recognized under the estate tax is unclear. See *Moskowitz v. United States*, 76-1 T.C. ¶ 13,117, 13,117-13,118 (N.D.N.Y. 1975).

an equity interest in an enterprise that is controlled by family members.²⁶⁷ Since the notion of a family enterprise is the very basis of the QUE rules, the same concept would be applied to help define the cessation of qualified status, which would occur: (a) on conversion to cash or non-QUE property; (b) upon cessation of family control; (c) upon listing of equity interests in the enterprise on an exchange; or (d) at the time equity interests in the enterprise are held by more than, say, twenty persons. Upon cessation of qualified status (other than by sale, etc.), equity interests would be valued without regard to minority-interest and lack-of-marketability discounts on the theory that the conditions giving rise to these discounts would be considered legitimate (not tax motivated) only so long as the enterprise is controlled by the family.²⁶⁸ When that ceases to be the case, both willing buyers and willing sellers would seek to maximize value by removing restrictions affecting value.

The QUE rules would be mandatory. There would be no "tax election" to value a QUE on receipt. The deferral rule would only apply to the QUE itself. Any cash realization (dividend, partnership distribution, and even possibly retained profits invested in liquid assets) from the QUE over time would be treated as an accession. These cash realizations would be the functional equivalent of trust distributions.

An alternative approach would be to tax the accession of a QUE but to defer the tax with interest.²⁶⁹ However, this approach would not avoid the valuation problems relating to QUEs, and would encourage the playing of valuation games (and possible attendant destruction of values). The calculation of interest, a minor annoyance in itself, would generate strong objections to the deferred-tax approach in cases where, as the tax liability waxes, the value of the underlying asset wanes.

b. Look-Through for Investment Holding Companies

The status of a family enterprise as an investment holding company should be disqualifying (upon receipt or thereafter) of QUE status. The argument to the effect that deferral of the accession date would preserve a family way of life (and accommodate liquidity concerns) is drastically weakened when the enterprise is nothing more than a portfolio of liquid

267. The current pattern of the Internal Revenue Code is to define "family member" (or "related party") in purely specified-relationship terms. See I.R.C. §§ 267(c)(4), 2701(e), 2704(c). This formalistic approach should be reconsidered. The definition should include the usual suspects (spouses and descendants of grandparents), but should extend at least to situations involving cohabitation and the actual provision of support (living expenses) and, in certain circumstances, might include ex-spouses and spouses of related parties.

268. Non-economic bonds and trust would plausibly explain the voluntary destruction of economic value for an indeterminate period.

269. See Batchelder, *supra* note 10. Deferral of tax (with an interest charge) has a few antecedents in the current Code. See I.R.C. §§ 453A(c), 1260(b), 1291, 6166.

investments (in an enterprise container).²⁷⁰ There is ample precedent under the income tax for disregarding the entity status of investment holding companies.²⁷¹

In the accessions tax context, a look-through rule would have the effect of prorating asset values among equity interests without discounts for minority interests or for the lack of marketability of the equity interests in the holding company.

It would be easier to define investment holding company in terms of asset composition than in terms, say, of “active management by family members.”

c. Limited Deferral for Estate Freeze Gifts

A final issue relates to a non-QUE junior equity interest that is involved in an entity estate freeze situation. Although the freeze scenario does not involve a lapsing interest or restriction,²⁷² there exists the potential of a concealed shift in value to the junior equity interest over time that would not be captured by disregarding lack-of-marketability and minority-interest discounts or by using more sophisticated valuation techniques.²⁷³ Any such concealed transfer of wealth would take the form of services, namely, entrepreneurial skill in increasing the value of the enterprise (and, therefore, of the junior equity). Since the performing of services by one person for the benefit of a related party has been generally considered to lie beyond wealth transfer tax systems,²⁷⁴ the question is whether an exception should be created to deal with the entity estate freeze scenario.

Suppose that successful artist (say, Jasper Johns) makes a gift to *P* of a canvas containing an unsigned rough sketch by the artist (which is clearly an unfinished work having a low current value). Subsequently, the artist finishes the work, thereby greatly enhancing the value of *P*'s property.²⁷⁵ Self-created assets are considered “property” under the income tax,²⁷⁶ and arguably the situation described here can be described as a two-step transfer of property under an accessions tax. The step-transaction doctrine of the income tax can be adapted to this situation to

270. See Duff, *supra* note 34, at 31–33, 58–62.

271. In the income tax, look-through rules for personal holding companies and other controlled enterprises have long existed. See I.R.C. §§ 541, 951 (2006 & Supp. I 2007).

272. See *supra* text accompanying note 260 (describing the entity estate freeze transaction).

273. See *supra* text accompanying note 263 (describing the “minimum 10% of enterprise value” rule).

274. *Comm'r v. Hogle*, 165 F.2d 352 (10th Cir. 1947).

275. A cognate example would be a carpenter making a gift of building materials to daughter *D* and then constructing a house with these materials.

276. Gifts of self-created property are effective to shift the gain (attributable to personal services). See I.R.C. § 1015 (2006). Appreciation on the stock of a corporation carrying on a services business produces capital gain.

hold that completion of the painting should be viewed as a transfer of property by relation back to the initial gift of the sketch.²⁷⁷

Carrying this analysis over to the entity estate freeze scenario, the initial gift of junior equity would be at its (low) fair market value, and a second accession (the then value of the junior equity reduced by the initial accession amount, if any) would occur at the date the donor relinquishes control over the entity. This delay would not extend beyond the donor's death.²⁷⁸ Of course, a definition of "control" would need to be constructed for this purpose.²⁷⁹

2. *Estate Accessions of Items of Sentimental Value*

Household and personal items that decline in value over time (consumer goods) can be characterized as "transferor" consumption that should generally be excluded from the accessions tax system. Inter vivos gifts of such items would usually be excludible as consumption gifts.²⁸⁰ In the case of accessions of such items from a decedent, valuation would usually not be worth the effort. The exclusion of such items can be limited in various ways to avoid abuse, such as by removing from the exclusion all motor vehicles but one, movable residences, and anything that cost the decedent more than, say, \$20,000.

Estate sales of such items prior to the accessions tax valuation date would remove the items from the exclusion by converting them to cash. Similarly, a sale by a legatee after receiving the item in-kind should produce a delayed accession equal to the sales price, but a sale that produces a trivial amount is probably not worth accounting for. Thus, there should be a separate per-legatee exclusion of, say, \$10,000 for sales proceeds attributable to consumer goods acquired from a particular decedent.

3. *The Decedent's Personal Residences*

The only person who has any kind of claim to succeed to the decedent's ownership of a personal residence without paying full accessions tax is that person's surviving spouse (however defined), and

277. There are various versions of the step-transaction doctrine, but the basic factual predicate is that of prearrangement. In this case, the prearrangement can be inferred from the fact that a gift of an unsigned incomplete sketch makes no sense apart from a plan to complete the work.

278. Section 2036(b) only applies where the donor retains voting rights to transferred stock. I.R.C. § 2036(b). The rule proposed here looks to the donor's continuing control over the enterprise, by whatever means. Rules that delay the completion of a transfer on account of retained powers are commonplace in the existing gift tax. See Treas. Reg. § 25.2511-2 (as amended in 1999). It is hardly a stretch to hold that the power to control an enterprise is a power over junior equity interests therein. Although the government narrowly lost on this issue under the current estate tax in *United States v. Byrum*, 408 U.S. 125, 143-44 (1972) (a six to three decision), that case was dependent on the language of section 2036(a)(2) of the estate tax, which would be superseded under an accessions tax statute. See I.R.C. § 2036(a)(2).

279. For a definition of control, see I.R.C. § 2036(b)(2).

280. See *supra* Part III.B (treatment of accounting for gross accessions).

that scenario will be accommodated by the spousal exclusion. Any rule that confers an accessions tax exclusion on personal residences for nonspouses will only encourage excessive investment in this type of property.

Nevertheless, an exclusion for the decedent's principal residence may have political appeal. It would be possible to construct a deferral rule, modeled on the QUE rules, for an accession to a principal residence conditioned on the property being the principal personal residence of the legatee.²⁸¹ Cessation of such use would cause the deferral privilege to lapse.

4. *Collectibles and Other Nonliquid Assets*

Collectibles (items of tangible personal property having appreciation potential, including artwork from the estate of an artist) would not come within the exclusionary rule for household effects. Nevertheless, collectibles present valuation and (in some cases) liquidity problems, as would large tracts of unimproved land, and perhaps other non-QUE assets.

Although the general rule should be that the accession occurs when property is received in-kind, the person receiving the accession (or, in some cases, the estate of a decedent) would be able to apply to the IRS for deferred-accession treatment for good cause shown. In this context, "good cause" would mean that the property poses a liquidity problem for the person receiving the accession, and that liquidation of the asset at its full value would take time. Any deferred-accession treatment conferred by the IRS would be conditional on the submission of an inventory and a commitment that the net sales price of any item would be reported as an accession. The IRS might also impose an outer time limit for the orderly liquidation to take place. The delayed-accession approach would be advantageous for the IRS to avoid a possible blockage discount.²⁸²

CONCLUSION

The general conclusion is that the accessions tax is far superior to the existing estate tax system in terms of its acceptability and non-interference with respect to the planning and drafting of gratuitous transfers.

As to design, the attempt herein has been to reinvent the accessions tax from the ground up, according to its own internal logic, as a tax on gratuitous receipts, as opposed to merely grafting features of the existing

281. See *supra* Part IV.C.1 (discussing treatment of legal life estates and trust equivalents).

282. Blockage discounts have been granted under the estate tax for large blocs of over-the-counter stock and the unsold artwork of a deceased artist. See *Estate of Smith v. Comm'r*, 57 T.C. 650, 658 (1972), *acq.*, *aff'd on other grounds*, 510 F.2d 479 (2d Cir. 1975); see also *supra* Part III.B.6 (critiquing the concept of a blockage discount).

transfer taxes onto some new, but barely visible, root stock. The most distinguishing feature of the accessions tax is the principle that accessions would be deferred past the time of transfer to the time of receipt in cash or assets that do not create liquidity problems. The treatment of trusts, life insurance, and other devices to effect future transfers would be greatly simplified, and both the motive and means of illegitimate tax avoidance would be largely choked off.